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IMPACT OF THE U.S. TAX CODE ON THE MARKET FOR CORPORATE CONTROL AND JOBS

HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

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IMPACT OF THE U.S. TAX CODE ON THE MARKET FOR CORPORATE CONTROL AND JOBS

THURSDAY, JULY 30, 2015

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:32 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Rob Portman, Chairman of the Subcommittee, presiding.

Present: Senators Portman, Lankford, Ayotte, Sasse, Johnson (ex officio), and McCaskill.

Staff present: Brian Callanan, Mark Angher, Matt Owen, Andrew Polesovsky, Daniel Strunk, Gabriel Krimm, Arielle Goldberg, Brandon Reavis, Sarah Garcia, Mel Beras, Tom McDonald, Amanda Montee, Emerson Sprick, Kelsey Stroud, Zachary Rudisill, Liz Herman, Samantha Roberts, Satya Thallam, Bryan Barkley, and Chris Barkley.

OPENING STATEMENT OF SENATOR PORTMAN

Senator PORTMAN. Good morning. Thank you all for being here, and I appreciate the fact that Chairman Johnson joined us, too.

I want to begin by thanking Claire McCaskill. This is Senator McCaskill's and my first hearing together as Chair and Ranking Member of the Subcommittee. I am glad to have a chance to team up with her again. We actually led a Subcommittee on Oversight in the last Congress. I was in that chair, she was in this chair. But we worked very well together, and as some of you know, she is a former State auditor and a prosecutor all in one, so she is very effective at oversight. And we will see that again today and going forward with so many of our projects.

This is a unique organization, this Subcommittee. The Permanent Subcommittee on Investigations (PSI) has investigative powers that allow us to do deeper dives in conducting our oversight of the Federal bureaucracy. We also want to use this Subcommittee to build a foundation for policy, and that is really what we are doing today. And then, finally, we are going to be rooting out some private wrongdoing that warrants a public response. Together, Senator McCaskill and I have a number of very interesting, long-term projects underway at PSI today that would fit in each one of these three categories.

This morning, we are going to focus on an important policy issue, as I say, and that is, frankly, how the U.S. Tax Code affects the

market for corporate control. This topic involves the jargon of corporate finance, as we will hear today, but what it really involves is jobs and investment. And it is negatively impacting our economy today because our Tax Code is not working.

We see the headlines every week, practically, about the loss of some American corporate headquarters. More often than not, it is to a country that has a more competitive corporate tax rate—that is easy to find when you have the highest rate among all the developed countries—but also countries that have a different international system, a territorial system of taxation.

Our Tax Code, frankly, just makes it hard to be an American company, and it puts U.S. workers at a disadvantage. At a 39-percent combined State and Federal rate, the United States does have the highest rate among the industrialized world. Adding insult to injury, our government taxes American businesses for the privileges of taking their overseas profits and reinvesting them here at home, which is something we should be encouraging, not discouraging.

Economists will tell us that this burden of our tax on the corporate side falls primarily on workers in the form of lower wages, fewer job opportunities, and, again, that is really what is at stake here.

All of our competitors have cut their corporate taxes and eliminated repatriation taxes, including our neighbor to the north; just about all of them have. We have not touched our corporate tax rate really since the 1980s. We have not changed our international code in any significant way since the 1960s. In the meantime, every one of our competitors has. As a result, too many American businesses are headed for the exit, and this is at a loss of thousands of American jobs.

The unfortunate reality is that U.S. businesses are often more valuable in the hands of foreign acquirers who can reduce their tax bills. It is one reason that you see this big increase in foreign acquisitions of U.S. companies. Last year, we now know, the number of foreign takeovers increased. In fact, last year it doubled to $275 billion from the year before. So doubling in terms of the value of foreign acquisitions of U.S. companies last year from the previous year.

This year, we are on track to surpass $400 billion—so it went from $275 to $400 billion—according to Dealogic, again, far outpacing the increase in overall global mergers and acquisitions.

It should be very clear that foreign investment in the United States is essential to economic growth. We want more of it. That is not the issue. But we want a Tax Code that does not distort ownership decisions by handicapping U.S. businesses. That is not good for our U.S. economy, and that is what we have today.

What is happening is that the current tax system increasingly drives U.S. businesses into the hands of those best able to reduce their tax liabilities, not necessarily those best equipped to create jobs and increase wages here at home. That is, of course, bad for American workers and bad for our long-term competitiveness as a country.

To better understand the trend and inform legislative debate over tax reform, this Subcommittee has decided to take a hard look

at this issue. Over the past several months, the Subcommittee has reviewed more than a dozen recent major foreign acquisitions of U.S. companies and mergers in which U.S. firms relocated overseas. Again, this was a bipartisan project. Senator McCaskill's experienced team at PSI worked with us every step of the way. I am grateful for that.

Today's hearing is the culmination of that hard work. We will hear directly both from U.S. companies that have felt the tax-driven pressures to move offshore and from foreign corporations whose tax advantages have turbocharged their growth by acquisition.

One such foreign company is Quebec-based Valeant Pharmaceuticals. Over the past 4 years, as we will talk about, Valeant has managed to acquire a slew of U.S. companies worth more than $30 billion. The Subcommittee reviewed key deal documents to understand how tax advantages affected Valeant's three largest acquisitions to date, including the 2013 sale of New York-based eye care firm Bausch & Lomb and the 2015 sale of North Carolina-based drug maker Salix. We learned that in those two transactions alone, Valeant determined it could shave more than $3 billion off the target company's tax bills by integrating them into the Canadian-based corporate group. Those tax savings meant that Valeant's investments in its American targets would have higher returns and pay for themselves more quickly—two key drivers, of course, of any acquisition. All three Valeant acquisitions we studied, unfortunately, came with job loss in the United States.

Beyond inbound acquisitions, America is also losing corporate headquarters through mergers in which U.S. companies relocate overseas. The latest news is the U.S. agricultural business Monsanto's proposed $45 million merger with its European counterpart, Syngenta. A key part of that proposed deal, as we understand it, is a new global headquarters not in the United States but in London.

To better understand this trend, the Subcommittee chose to review in detail the 2014 merger of Burger King with the Canadian coffee and donut chain Tim Hortons, an $11.4 billion agreement that sent Burger King's corporate headquarters north of the border. A review showed that Burger King had strong business reasons to team up with Tim Hortons. But the record also shows that when deciding where to locate the headquarters of the combined firm, tax considerations ruled out the United States.

At the time Burger King estimated that pulling Tim Hortons into the worldwide U.S. tax net rather than relocating to Canada would destroy up to $5.5 billion in value over just 5 years—$5.5 billion in an $11 billion deal. Think about that.

The company concluded it was necessary to put the headquarters in a country that would allow it to reinvest overseas earnings back in the United States and Canada without an additional tax hit. They ultimately chose, of course, Tim Hortons' home base of Canada.

Both Valeant and Burger King played by the rules. I think that is an important point to be made. They and their deal partners responded to economic pressures, opportunities, and incentives created by our tax laws. If there is a villain in this story, it is the U.S.

Tax Code. And, frankly, it is Washington not doing what Washington should be doing to reform it.

My goal is to use these examples this morning and others we will hear about today to better understand the need to overhaul our broken corporate Tax Code and put U.S. businesses and workers on a level playing field.

Again, I thank the witnesses for being here, and I would like to hear now from Senator McCaskill her opening statement.

OPENING STATEMENT OF SENATOR MCCASKILL

Senator MCCASKILL. Thank you so much, Chairman Portman.

Let me say what a great honor it is to sit on this dais for the first time as the Ranking Member of the Permanent Subcommittee on Investigations. This is the Truman Committee. This Committee was formed when Harry Truman got in his car with no staff and drove around the country investigating war profiteering in World War II. This is how he made his reputation in the U.S. Senate, and many historians say it was his work on this Committee that vaulted him into consideration for the Vice Presidency and ultimately the Presidency of the United States.

I am a huge Harry Truman fan for many reasons. His mouth used to get him in trouble almost as much as my mouth gets me in trouble. And he also did some courageous things that were not poll-driven in his day. I am honored to hold his seat in the Senate, and I am thrilled—it is a lifelong dream—to be able to sit on this investigative Subcommittee and try to do the kind of work that taxpayers would be proud of.

I know that Chairman Portman and I can work together well in a bipartisan way to uphold PSI's long history of bipartisanship in a way that is worthy of President Truman's legacy.

I am also pleased to see a long-time Missouri business here today—Emerson Electric Company, now celebrating 125 years in St. Louis. Mr. Galvin, we are happy to have you here today to offer your thoughts on this important issue.

Today I think we are in agreement that the current U.S. tax system is broken and needs reform. Our corporate tax rate is among the highest in the industrialized world. Our worldwide tax system is out of sync with the territorial models our economic peers have implemented. We lag behind other countries in the Organisation for Economic Co-operation and Development (OECD) in the value of the research credits we provide, and we risk losing out as our European allies move forward with new plans to incentivize the flow of intellectual property to their borders.

On a very timely note, we are putting the Export-Import Bank in jeopardy of existence, which is also another tool that our manufacturers use in this country to compete on a worldwide basis, since most of our economic peers have a similar type of bank in their countries that is helping finance exports and imports.

We see the effects of these problems every day. We see more and more profits and intellectual property shifted out of the United States to low-tax jurisdictions overseas. We see U.S. companies stashing over $2 trillion in earnings overseas to avoid the tax rate they would face upon bringing that money back to our shores. And

we see increasing numbers of U.S. companies heading for the exits, whether through an inversion or by otherwise relocating overseas.

At the same time, we are witnessing a huge upswing in cross-border mergers and acquisitions activity—$1.3 trillion in deals in 2014 alone, with foreign takeovers of U.S. companies accounting for $275 billion of that total. This is double the value of takeovers in 2013, and every expectation is the boom will continue throughout 2015. This increasing trend merits an examination about the causes of this merger impact and the larger impact on jobs, tax revenue, and innovation.

Some argue that, absent the advantages the U.S. Tax Code provides to foreign multinational corporations, many of the U.S. companies acquired in these takeovers could have remained in American hands. In this view, the combination of a high U.S. corporate tax rate and a worldwide taxation system makes U.S. acquirers uncompetitive, while foreign acquirers can employ aggressive tax planning strategies that boost the value of U.S. assets and allow them to make higher offers.

The reality may not be quite so simple. We know from previous hearings before this Subcommittee that many U.S. multinational corporations are adept at avoiding repatriation of their overseas earnings and are just as active as their foreign counterparts in shifting income and IP out of the United States. As a result, effective corporate tax rates for some U.S. multinationals can fall below the low statutory rates in other countries.

In 2013, for example, the Government Accountability Office (GAO) reported that the 2010 effective worldwide U.S. corporate tax rate for profitable companies was only 12.6 percent. Similarly, a study from the University of Michigan found that the effective tax rates of the 100 largest U.S. multinationals from 2001 to 2010 were actually lower than the rates for the 100 largest multinationals in the European Union.

The solutions offered to address the competitiveness gap between U.S. multinationals and foreign multinationals are also not quite so clear cut. Tax experts estimate that because of profit shifting techniques by foreign multinationals, U.S. companies will remain at a disadvantage so long as the U.S. statutory corporate rate is above 15 percent—which is significantly below the rates in previous bipartisan tax reform proposals. The move to a territorial system also carries the risk of providing greater incentives for companies to shift profits overseas, and a territorial model without stringent rules to prevent abuse and ensure transparency could cost taxpayers over $100 billion over 10 years. Many other countries are employing an "innovation box" through which business income derived from intellectual property development is taxed at a preferential rate. This is a very promising approach, but there are challenges. We have to determine which IP rights we should protect and the types of research and development (R&D) activity that we should incentivize.

As we move forward in this discussion, I want us to keep a few points in mind.

First, I believe that U.S. competitiveness ultimately depends on continued investment in public goods like our world-class research universities, our highly skilled workforce, our strong rule of law,

and infrastructure that is needed to support business activity in the 21st Century. As a result, we should guard against any tax reform measures that threaten to erode the U.S. tax base and undermine these very clear-cut advantages the United States of America offers to the business world. This effort will require implementing anti-abuse provisions to ensure a shift to a territorial system does not provide an even greater incentive for multinationals to move profits overseas.

Second, tax reform—particularly revenue-neutral tax reform—will necessarily involve gains for some and losses for others. As we discuss the challenges U.S. multinationals face, we should not lose sight of the challenges faced by domestic U.S. businesses—the companies that account for four out of five jobs in this country. These businesses already operate at a tax disadvantage relative to their multinational competitors, and they should not lose out on tax credits that support domestic manufacturing and research and development to compensate for lowering taxes on foreign income.

Finally, we should resist the urge to demonize foreign companies operating inside the United States. Foreign direct investment brings $3 trillion to the U.S. economy. For every non-U.S. company that grows through rapid acquisition and severe cuts to research and development and employment, countless others invest in their communities and provide much needed manufacturing jobs. Robust foreign direct investment in the United States is not just a consequence of globalized competition; it is a tremendous advantage for our economy. Our challenge is to ensure that when U.S. companies choose to grow their businesses through domestic acquisition, our Tax Code does not tip the scales in favor of foreign acquirers.

My hope for the hearing today is that our witnesses can help us understand the role the U.S. Tax Code plays in competition between U.S. acquirers and foreign acquirers. I also hope we can gain insight into how the Code influences corporate decision-making and how we can address the problems in the existing tax system while still ensuring that the United States continues to build the infrastructure and maintain the tax base necessary to be a leader in innovation, research and development, and business opportunities.

I think I could not agree more with the Chairman. Our Tax Code is broken. Our Tax Code needs to be fixed. We are going to have to have the political will to do it. And blaming companies for doing the math that our Tax Code represents is a waste of time. And what Congress needs to do instead is hold the mirror up to ourselves because it is our inability to come together and compromise in a comprehensive way that is holding us back from reforming our Tax Code in a way that levels the playing field for our businesses, not just in the global marketplace, but right here in the United States of America.

I look forward to working hard with my colleague Senator Portman and Senator Johnson and other Republicans, Senator Lankford, to find those compromises necessary to level that playing field and quit blaming companies for simply doing the math.

Thank you, Mr. Chairman.

Senator PORTMAN. Thank you, and great points.

Senator Johnson has to go to another hearing in a moment, so I am going to ask him if he has a brief opening statement as well.

And, Senator Lankford, thank you for joining us as well. Senator Johnson.

OPENING STATEMENT OF CHAIRMAN JOHNSON

Chairman JOHNSON. I will be very brief.

First of all, I just want to commend both the Chairman and the Ranking Member for holding this first hearing. I think it is very appropriate. If you take a look at the weaknesses in our system that are preventing us from growing, it really is a very uncompetitive tax system. And, I really appreciate Senator McCaskill's saying we should not be demonizing businesses and we should be looking at these structural problems we have, and we should be incentivizing job creation, pointing out that the true villain really is a Tax Code that is completely uncompetitive.

I come from the business world. A basic principle in business is benchmarking yourself against your competition. Well, as a Nation state, we have to do the same thing. We have to benchmark our Tax Code, our regulatory environment, against our global competitors. It is not that hard to do. What is difficult is developing the political will and achieving those compromises to actually enact it.

So, again, I have read the briefing. I think the staff—I want to commend them as well—has done an excellent job of laying out the case. I have often said that the first step in solving any problem is you have to properly define it and you have to admit you have it. And so rather than demonizing businesses, let us point out that the villain here really is a very uncompetitive Tax Code. This is that first steps in defining the problem so we can take—the real first step is admitting we have it.

And, again, I just want to commend you. I wish I could be here for the whole hearing. I will pop in and out as best I can. This is an excellent first hearing, so thank you.

Senator PORTMAN. Thank you, Senator Johnson.

We will now call our first panel of witnesses for this morning's hearing. The hearing is entitled "The Impact of the U.S. Tax Code on the Market for Corporate Control and Jobs." I would like to welcome our three panelists here on the first panel.

The first one is Jim Koch. Jim is founder of the Boston Beer Company, the brewer of Sam Adams beer.

The second is David Pyott. David is the former Chairman of the Board and Chief Executive Officer (CEO) of Allergan. Thank you, David.

And then Walter Galvin is here. He is the former Vice Chairman and Chief Financial Officer (CFO) of Emerson Electric.

All three have great experience and expertise to bring to bear on this, and we appreciate their willingness to come forward this morning.

I would ask you to stick with our timing system this morning. All of your written statements will be included in the record, and we want to have plenty of time for questions with you. We are going to ask you to limit your oral testimony, if you could, to 5 minutes. Mr. Koch.

TESTIMONY OF JIM KOCH,[1] FOUNDER AND CHAIRMAN, BOSTON BEER COMPANY

Mr. KOCH. Thank you, Chairman Portman, Ranking Member McCaskill, Senator Johnson, Senator Lankford. It is an honor to be here today as your Subcommittee investigates how the current corporate tax structure in the United States should be reformed to lessen the obstacles to starting, growing, and maintaining an American business.

It is a little uncomfortable for me because I am not used to talking without a beer in front of me, but I will try to do it on plain old water. [Laughter.]

Senator MCCASKILL. We could probably send out for one if you need one. If you get halfway through it and you need a beer, just let us know.

Mr. KOCH. That would be good. Thank you.

The Boston Beer Company had humble beginnings. I used my great-great grandfather's recipe actually from the Soulard district of West St. Louis, where his brewery stood in the 19th Century. And I started brewing in my kitchen in 1984. I went from bar to bar to sell the idea of a rich, flavorful American beer, which was quite novel. Thirty years ago, I named my beer after the American revolutionary and Founding Father Samuel Adams, whose statue stands in the capitol representing Massachusetts. Boston Lager was released in April 1985. And 6 weeks later, it got picked as the "Best Beer in America" at the Great American Beer Festival.

Today, our family of beers includes over 60 varied and constantly changing styles of beer. We are now available in all 50 States and in 30 foreign countries. Today Boston Beer Company is a team made up of 1,300 American employees with breweries in Boston, in Cincinnati where I grew up, and in Pennsylvania. We have invested over $300 million in those breweries in the last 3 years, and we are proud that today the craft beer industry, which when I started was just a handful of semi-lunatics, has grown to over 3,600 local businesses all across the United States.

But despite that growth, today almost 90 percent of the beer made in the United States is made by foreign-owned companies. And foreign-owned breweries have now begun acquiring American craft brewers with 9 of the most successful ones having been acquired in recent years. So I am concerned that growing and expanding an American-owned brewery is increasingly difficult because our corporate tax structure places American-owned companies at a competitive disadvantage to our foreign counterparts.

It is not uncommon for me to receive visits from investment bankers interested in facilitating the sale or the merger of Boston Beer Company to foreign ownership. One of the principal financial benefits of such a transaction is to reduce the tax rate we pay. We are vulnerable because we currently report all 100 percent of our income in the United States, and as a result, we pay a tax rate of about 38 percent on all of that income. Under foreign ownership, that rate, I am told by investment bankers, would be reduced to the range of 25 to 30 percent immediate through various practices like expatriation of intellectual property, earnings stripping and

[1] The prepared statement of Mr. Koch appears in the Appendix on page 47.

the strategic use of debt, offshoring of services, and transfer pricing. So that means that a dollar of pre-tax earnings is worth 62 cents to me under American ownership but about 72 cents under foreign ownership. To put it another way, Boston Beer Company is worth 16 percent more to a foreign owner simply because of the current U.S. tax structure.

Why haven't we sold Boston Beer Company to a multinational or another foreign entity? The simple answer: It is just not who we are. I named my beer "Samuel Adams" after our patriot namesake. We were born in America. We have grown because of the advantages available in the United States, and we do not mind paying our taxes here in the United States in gratitude for the opportunities that exist in this country and that I certainly have enjoyed.

But do not mistake that for good financial decisionmaking. I have to explain to shareholders why we have not taken advantage of some of the strategies available to reduce our corporate tax burden by moving overseas. In response to economic pressures, other companies are saving millions, or hundreds of millions of dollars through complex tax planning every year. And rest assured Senators, while we are sitting here talking about corporate tax reform, there are folks in offices and boardrooms all over the world making their own version of corporate tax reform every day. The difference is that not one of them is accountable to your constituents. So Congress' inaction on this subject has created a system of do-it-yourself corporate tax reform that is available to few and understood by even fewer. Because of our broken corporate tax system, I can honestly predict that I will likely be the last American owner of the Boston Beer Company.

Due to hard work, innovation, and diligence, American craft brewers have created thousands of well-paying manufacturing jobs and created respect for American beer all around the world. I know of no manufacturing sector in the United States that has grown for 30 straight years and achieved double-digit growth for 16 straight quarters. But when these foreign acquisitions occur, American jobs are often cut or shipped overseas, less investment is made here in the United States, and other cost-cutting measures on management and sales forces are implemented along with reductions in local philanthropy and community involvement.

The solutions are pretty clear: Cut the highest-in-the-world U.S. corporate tax rate to the mid-20s; bring America's international tax system in line with the rest of the industrialized world by allowing U.S. companies to bring their overseas earnings home—just like the British and Canadians allow their businesses to do. And Senator Portman's recent proposal with Senator Schumer provides a strong, bipartisan road map on the international piece of tax reform. With these reforms, I believe we can unleash a lot of job creation and innovation in this country. And without them, I fear America will fall behind economically.

Thank you.

Senator PORTMAN. Thank you, Mr. Koch. Mr. Pyott.

TESTIMONY OF DAVID E.I. PYOTT,[1] CHAIRMAN AND CHIEF EXECUTIVE OFFICER (1998–2015), ALLERGAN

Mr. PYOTT. Thank you, Chairman Portman and Ranking Member McCaskill, Senators Johnson and Lankford.

My name is David Pyott, and I am the former Chairman and CEO of Allergan. Until it was acquired by Actavis in March 2015, Allergan was a great 65-year-old American pharmaceutical company, a world leader in ophthalmology, medical aesthetics, and Botox therapeutic as well as cosmetic.

In my 17-year tenure as CEO, Allergan experienced tremendous growth, going from $600 million in sales in 1997 to more than $7 billion in 2014. Lots of jobs were created, going from 4,000 to 10,500.

Growth was principally organic and R&D-driven. Allergan's R&D investments increased from less than $100 million in 1997 to over $1 billion in 2014, leading to a steady stream of regulatory approvals by the Food and Drug Administration (FDA).

In early 2014, Allergan's outlook was bright: We projected double-digit revenue growth and mid-teens increases in earnings per share for the next 5 years.

But, ultimately, those qualities—sustained growth, robust R&D, and $4 billion in cash, most of it located overseas—made Allergan a very attractive target for acquisition, especially for a foreign company.

The U.S. Tax Code, as we have heard, creates advantages that are worth billions for foreign acquirers to buy up American companies.

So what happened in 2014? We were targeted by Valeant, a Canadian company that has acquired over 100 pharmaceutical, medical device, and OTC companies in the last 7 years in a roll-up strategy. Valeant has the clear strategy of not investing in R&D. Valeant had just completed an $8 billion acquisition of Bausch & Lomb in 2013 and was too weak and laden with debt from that transaction to be able to buy Allergan on its own. So Valeant entered into a partnership with Pershing Square, run by activist investor Bill Ackman, to go after Allergan together. It was the first-ever partnership of its type. In the February to April 2014 timeframe, using stock purchases and then options and derivatives, Pershing Square was able to accumulate 9.7 percent of Allergan's shares without making any public announcement.

On April 22, Valeant bid $47 billion to buy Allergan, an increase from the $37 billion valuation when Pershing Square initiated its first purchases of stock, a premium, obviously, of $10 billion, or about 25 percent. Such a premium was enabled by the enormous tax savings available to Valeant, with a 3-percent worldwide corporate tax rate, allied with their rapacious cost-cutting plan.

In its pitch to investors, the Valeant plan was to reduce Allergan's 26 percent effective tax rate to 9 percent, a difference of 17 percent, or $500 million per year. Applying a price earnings multiple to this $500 million, this gives Valeant and Pershing Square roughly a $9 billion valuation advantage. In simple terms,

[1] The prepared statement of Mr. Pyott appears in the Appendix on page 49.

thinking back to the math, Allergan was worth $9 billion more—simply by being moved to foreign domicile.

On the day of announcing the bid, Pershing Square interestingly posted a profit of almost $1 billion. I sincerely hope that the SEC will investigate this novel structure regarding possible breach of the insider trading laws and other securities regulations.

But back to Valeant. The Allergan Board felt that the offer substantially undervalued the company. Valeant's plan was also to strip Allergan, cutting overall operating expenses by 47 percent, slashing R&D within that from more than $1 billion to just over $200 million per year, along with other market-building investments.

Valeant planned to load up Allergan with more than $22 billion in new debt, taking the debt load of the combined company to more than $50 billion.

After assessing many strategic alternatives, the Allergan Board ultimately decided to seek out a so-called white knight. Of the potential suitors, it was clear to me that only a foreign-domiciled company could be in a position to outbid Valeant while still creating value for their own stockholders. Obviously, as we have heard, foreign acquirers have lucrative tools: debt pushdown, migration of intellectual property. Valeant contemplated both.

In November 2014, Irish-domiciled Actavis bid $66 billion for Allergan. Similar to Valeant, Actavis could immediately reduce Allergan's effective tax rate—from 26 percent to 15 percent. Beyond just selling to the highest bidder, the Allergan Board assessed an acquirer's commitment to innovation. Unlike Valeant, Actavis was and is committed to maintaining the best of Allergan in the combined company.

Given the premium that had to be paid to secure control of our company, cost synergies, of course, had to be found, about $1.8 billion, a modest 11 percent of operating expenses across both companies.

As for jobs, I am no longer with the company, but estimate that about 1,500 jobs will be eliminated from the legacy Allergan side, mostly in California. The reduction in R&D thank goodness has been modest.

With this sale, we could salvage what we could of a great American company. The last operating year was the best in our 65-year history. Sales increased by 16 percent, or over $1 billion to $7.1 billion. As a point of pride, Actavis adopted Allergan as the new corporate name in June 2015.

Looking back, I am convinced that Allergan today would have remained an independent, American company had it not been for the significant disadvantages caused by our uncompetitive U.S. corporate tax system. The implications are clear, not only for the pharmaceutical and biotech industry, but extend across many industries that are global. Unless Congress acts, I believe that many more innovative American companies will be lost.

Thank you for the opportunity to testify about my interesting experience.

Senator PORTMAN. Thank you, Mr. Pyott. Mr. Galvin.

TESTIMONY OF WALTER J. GALVIN,[1] VICE CHAIRMAN (OCTOBER 2009–FEBRUARY 2013), AND CHIEF FINANCIAL OFFICER (1993–2010), EMERSON

Mr. GALVIN. Good morning, Chairman Portman, Ranking Member McCaskill, and Members of the Committee. My name is Walter Galvin. I am the former Vice Chairman and Chief Financial Officer of Emerson, a $25 billion global manufacturing company founded in St. Louis 125 years ago. Emerson has over 110,000 employees and operations in more than 150 countries.

In each of the last 3 years, Emerson paid $1.3 billion in taxes worldwide. Over half was paid in the United States.

Emerson's business is global. Over 55 percent of our sales are outside the United States, and several of our major competitors are domiciled abroad. Being domiciled in the United States means we pay more in taxes on a worldwide basis.

My testimony will focus on three areas: first, why America's tax cost on foreign profits is such a disadvantage to U.S. companies; second, how other nations have set examples we can follow; and, third, how Emerson can serve as an example of an American-based multinational that lost out to foreign competitors because of our Tax Code.

To begin, the combination of our high corporate tax rate and the way the U.S. taxes foreign profits can make U.S. companies more valuable in foreign hands—which is leading to American businesses being stripped away.

A recent analysis by Ernst & Young found that, from 2004 through 2013, foreign buyers acquired $179 billion more of U.S. companies than we acquired of theirs. Additionally, data provider Dealogic reports that the gross value of foreign takeovers of U.S. companies doubled last year to $275 billion and, at the current rate, will surpass $400 billion this year. These takeovers reflect thousands of U.S. companies leaving American shores.

How can we stop this accelerating exodus? Congress must remove the premium only American companies pay by moving to a territorial system and reducing the top corporate tax rate.

We know it can be done. Other nations, like the United Kingdom (U.K.), have successfully reduced their top rates. In 2009, the United Kingdom switched to a territorial system while their corporate rate stood at 28 percent. Now that rate is 20 percent, and earlier this month, the United Kingdom released a plan to drop that rate further to 18 percent.

Companies are taking note. Monsanto, an American company also founded in St. Louis more than 100 years ago, is attempting to merge with a competitor and set up a new parent company in the United Kingdom. It is no mystery why.

I have two real examples of how Emerson's investors, shareholders, and employees have been directly impacted by America's out-of-date Tax Code.

In 2006, Emerson sought to acquire a company called American Power Conversion (APC), a Rhode Island-based producer of high-tech electronic equipment. At that time over half of APC's earnings were made outside the U.S. Emerson competed against Schneider

[1] The prepared statement of Mr. Galvin appears in the Appendix on page 54.

Electric, a French company, and Ohio-based Eaton Corporation to buy APC.

Emerson valued the company at just under $5 billion, but Schneider ultimately acquired the company by bidding $5.5 billion. The principal reason Schneider's valuation of APC was higher was due to the French tax law on repatriation.

Headquartered in France, 95 percent of Schneider's repatriated profits are exempt from French taxes, so APC's profits are worth more to Schneider because they can be repatriated at a tax rate of under 2 percent. By contrast, if Emerson repatriated those earnings, we would be subject to a tax rate of approximately 17 percent. That 17 percent is the difference between our 35-percent corporate rate and foreign taxes we pay. The difference between Schneider's rate of 2 percent and Emerson's rate of 17 percent on a discounted cash-flow basis is worth $800 million more to Schneider. Therefore, Schneider was able to outbid Emerson, and what had once been an American company became a subsidiary of a French-domiciled company.

As for Eaton, they dropped out of the bidding process early and about 6 years later acquired Ireland-based Cooper Industries. Eaton is now an Irish-domiciled company, enjoying a lower worldwide tax rate.

Second, America's worldwide system creates a perverse incentive to keep foreign profits abroad. A few years ago, Emerson bought a company in the United Kingdom called Chloride for about $1.5 billion with cash we had earned abroad and kept abroad. We considered other options for that cash, but the United States would have charged us 10 to 15 cents in taxes on every dollar we bring back home. So where will we get a higher expected return—from one dollar invested in the United Kingdom or only 85 cents in the United States?

We need to reform the Tax Code sooner rather than later. Every time a company is acquired and the headquarters is moved, there is a real community impact. In addition to costing American jobs, this impacts local communities because of a decline in State and local taxes and a loss of corporate philanthropy and jobs.

I am grateful that the Portman-Schumer framework is moving the conversation forward.

In closing, we cannot expect to create more jobs at home if we continue to punish businesses like Emerson who want to remain headquartered here. America's businesses and workers are the best in the world, and we are not asking for a tax handout. We are asking for a level playing field. With that, we can compete with anyone in the world and win.

Thank you, and I welcome your questions.

Senator PORTMAN. Thank you, Mr. Galvin. And, look, I appreciate all three of you being here and testifying, and specifically going into some detail on case studies that involved your companies. We want to focus on the facts here, and you have given us some great studies.

We are going to have a couple rounds here. The first round will be 7 minutes each. The second round will be 5 minutes each. We have some colleagues who have shown up, and I know everybody

is under pressure, so I am going to try to keep my initial questions to less than 7 minutes.

I want to focus on a couple things. One, what I am hearing from you all is that there are a number of problems with the U.S. Tax Code and the perverse effect it has on U.S. jobs and investment. One is you are just less competitive, and it makes more sense to have your businesses in the hands of a foreign acquirer because of the tax savings. And there are some amazing numbers you have provided us here today, to the extent to which that is true.

Second, you talked about—and Mr. Galvin just mentioned the fact—that it is harder to grow as an American company, because when you are competing for acquiring another company, you are finding foreign competition coming in that can pay a premium because of their after-tax profits.

And then third is this whole issue that you have all referenced but that Mr. Galvin talked about, which is when you have this lockout effect, you have the money stuck overseas because you cannot bring it back because of the prohibitively high rate, it is an incentive to make your investments overseas, all three of which are bad for U.S. jobs.

So I guess I start with Mr. Koch, and I thought your analysis was really interesting. I heard you say something about investment bankers giving you a proposal frequently. Can you sort of pull back the curtain on that a little bit and tell us what is happening in the real world? Do you get proposals from investment bankers or others saying, why don't you do this inversion or why don't you make yourself a target for a foreign acquisition?

Mr. KOCH. Sure. And as we heard from the other panelists, if you are an attractive American company, you have the things that characterize American business. Innovation and creativity, willingness to sort of create a new industry—those things are very attractive to foreign owners, and that puts you on the radar screen. So investment bankers, that is what they do. They find these opportunities, and they work both sides, put them together. So it is a regular feature of my life, talking to investment bankers who can do the math.

Senator PORTMAN. Yes, so you have U.S. investment banking firms coming to your companies and saying, "Why don't you do this? This makes sense for you."

One final question. You talked about the fact that you may be the last U.S. owner of your company, sadly, and you talked a little about the shareholder pressure. Are you responding to that shareholder pressure by saying, we can become a foreign company and maybe make some savings, but, we have a commitment to this country? And how does that conversation go?

Mr. KOCH. Well, I am very fortunate, for two reasons. One, I have all the voting shares. [Laughter.]

So that helps. It is a wonderful form of democracy. I vote.

Senator PORTMAN. I wish I had that here. [Laughter.]

Mr. KOCH. It is a good thing. And the other is under Massachusetts law, I am not legally required to maximize shareholder value. I am not legally required to run the company only for the benefit of shareholders. But under Massachusetts law, I am allowed to

take into account the interests of other stakeholders. So that is about as good as it gets.

Senator PORTMAN. I suppose it is clear to everybody on the panel that that is a highly unusual situation, both in terms of having voting shares and also having this fiduciary responsibility be broader than it is in most of your cases. And I really appreciate your patriotism and your coming here today.

Mr. Pyott, if you could tell us a little more about shareholder pressure yourself. You had an amazing story to tell. Among others, you talked about the fact that when Valeant first made an offer for your company, it offered about a 25-percent premium, as I heard it from you, and you thought that they had about a $9 billion valuation advantage related just to taxes, that meaning that Allergan was much more valuable in their hands just because of the Tax Code.

Can you take us inside the board room for a minute? What were those conversations like? How do shareholders react to an offer like that?

Mr. PYOTT. Well, as you can imagine, the intent both by Valeant, allied with Pershing Square, because they could do different things, one being an activist, one being a strategic, was basically to put us into a tub of boiling hot fat. That was very clear, to bring us to the negotiating table ASAP.

Well, we stood back and, of course, we had a proud track record, because I was fortunate when I started at the end of 1997, the company was worth $2 billion. And thanks to the enormous growth that I spoke about, by the beginning of 2014 it was worth $37 billion on the New York Stock Exchange so people could not really complain that much about my team's poor performance.

So, of course, then comes the bid, and, of course, given the numbers I gave you, pretty much all of the bid premium was courtesy of the tax, right? So we knew this was, likely to be much higher, and, of course, we had our investment bankers at hand, and one of their principal jobs was to run numbers under various valuation metrics. What was the value of Allergan to a public shareholder? And it was very clear that the value was substantially higher than what was being offered, and so as a board, we could very much look in the mirror, look at ourselves, and say we have to do a lot better than this to get something approximating what we think—and not just we—the experts with our numbers reflect the true value.

And so we then got into a huge fight that lasted 8½ months, and I was screamed at, every time I went out, whether it was the media or especially the investment community to go and negotiate. And I said, look, I will not negotiate until there is a number on the table that is so close that one would think the market will clear. If somebody is a million miles off, beyond just shouting at each other, you do not get any reasonable outcome.

And due to some major performance-enhancing measures we took ourselves, because we had to get into our own cost-cutting campaign—right?—to drive up earnings per share or to drive up the intrinsic value of the company, we were able to really move up the value. And, happily, due to the culture we have, the team did not get distracted because you can imagine people were saying, you are on a path to hell, because with all this media opprobrium, literally

I could not keep out of the newspaper for more than 2 days. I am sure you all know what that feels like.

And I said to our team, if you do not focus on the business, we are lost. And they did a fantastic job, the best result for 65 years, which tells you about the spirit of the people.

And so that is the way we just kept moving things along, always steadily increasing the value of the company, until we reached a point where, in fact, I knew I could no longer hold the line, although I was constantly thinking—do I really go to a shareholder vote? And I seriously thought of it.

If I may, just one last thing, because I am giving you the various angles. The role of Pershing Square was very interesting, because, of course, having 10 percent of the vote out of the box is a powerful position. And then, clearly, the goal was to kind of create a wolf pack with those firms whose business is investment firms to pile in, in the so-called event-driven world of hedge funds. We were able to contain that whole community, Ackman plus the others, to actually 31 percent. And as you well know, 31 percent does not mean you lose the election. And my job was to win and keep the long-oriented investors in our position so that we theoretically could have won, 50 and one percent would have done it—right?—to keep control of the board. And then I am sure you want to come back to how then Actavis came in from the other side.

Senator PORTMAN. Yes, and I want to move on because I want to give my colleagues a chance to ask questions.

Mr. PYOTT. Absolutely.

Senator PORTMAN. But we are going to dig deeper into that, and also, Mr. Galvin, you are not off the hook here. I will be asking you some further questions in the second round, but I do want to go to my colleagues. Let me just make one comment, if I might. You were consistently named one of the best CEOs in America, and this was not a company that was floundering where an acquisition, might have made sense in order to change the management or to improve the business performance. This was tax-driven, clearly. So I think it is interesting to hear your story this morning, and, again, we will get into some further detail as to the next step and what the consequences were of the Tax Code on the actual acquisition and what has happened since. Senator McCaskill.

Senator MCCASKILL. Thank you very much.

I am curious, Mr. Koch. I confess I have not paid close enough attention to your marketing, but are you marketing that you are the largest American beer company in the United States of America?

Mr. KOCH. Not really. I mean, we try to sell our beer on the quality of the beer, the care and——

Senator MCCASKILL. You might think about it.

Mr. KOCH. OK.

Senator MCCASKILL. I am just telling you.

Mr. KOCH. OK.

Senator MCCASKILL. I do not think most Americans realize that you are the largest fully owned American beer company.

Mr. KOCH. It is sort of sad because we are little over one percent market share.

Senator MCCASKILL. I get it, but I am just saying.

Mr. KOCH. It is kind of crazy.

Senator MCCASKILL. I am just telling you, just for what it is worth.

I wanted to go back momentarily, Mr. Pyott, to your testimony. Did you say that Pershing posted $1 billion of profit the day they tendered the bid?

Mr. PYOTT. Very close. The number is $950 million.

Senator MCCASKILL. Is that being investigated now?

Mr. PYOTT. I sure hope so. But, of course, as you well know, if officials from the SEC come before you, they have to speak with enormous caution, and I have to admit that I have visited many Senators' offices, many Members of the House of Representatives, doing my best to encourage whatever oversight is possible.

Senator MCCASKILL. The former prosecutor in me kind of went, "What did he just say?"

Mr. PYOTT. Yes. Well, I mean, you can tell I'm a person of principle, and a lot of people in my shoes just move on.

Senator MCCASKILL. Goodness.

Mr. PYOTT. I am afraid I feel pretty strongly about a lot of things that happened last year. It was not just the Tax Code. You can say, the very slow reporting periods that our rules provide, are antiquated. Something has to happen in financial services as well. And those members agree with me.

Senator MCCASKILL. Let me talk to you all about the anti-abuse erosion measures. If we move to a territorial tax system, which I think all of us understand is—everyone should understand is, I believe, inevitable, everyone agrees that it has to include measures to prevent abuse and to limit the erosion of the U.S. tax base.

According to the Treasury Department, a territorial system without full rules on the allocation of expenses could result in $130 billion in lost revenue over 10 years.

So, some proposals are committed to revenue neutrality, which has raised difficult questions about how we compensate for lost revenue as a result of lowering corporate tax rates. So I would like to hear your perspective as business leaders on these hard choices. What kind of anti-abuse measures do you see would work or that you might support so that we do not fix a system and then all of a sudden wake up the next day and realize it is being gamed by everybody shifting expenses to once again do the kind of math calculations that put you in the position you were in? Let us start with you, Walter, if you would. Do you have recommendations on how we can put some rules in place that would provide a cautionary note for the abuses that could occur?

Mr. GALVIN. Well, my personal opinion would be you need to keep it relatively simple. You already have a tax rate with 35 percent base and all the earnings and profit calculations. So if you consider—and American corporations have always said a base rate of 5 percent is very attractive. A lot of the other international companies have a 2-percent base rate. So, internationally, if a company pays 10 percent in international taxes against the 15, they get that credit. They would only pay a 5-percent tax. But if an international company paid—a U.S.-based company paid a 2-percent international tax rate, which is probably suspicious even though totally

legal, they would have to pay an additional 8, or a total of 13 percent. So you would scale it back down.

Certainly, for a lot of companies, if you look at what the international tax rates are where companies participate, it's nowhere close to the tax rates currently being reported. So I think you need to do something. While it is a lot of work with the earnings and profit calculation, having a sliding scale between 5 and 15 should prevent some of the abuse, and companies that are paying a more ordinary tax rate over 10 percent should not have a problem with it.

Senator MCCASKILL. Do you agree with that approach in terms of preventing the kind of abuses that could really erode our tax base?

Mr. PYOTT. Well, my sort of general view is that I think if we can get our headline tax rate down into the same kind of target zone as the rest of the industrialized countries, then we have solved a lot of problems of what I call "around the edge." And I think the whole matter of how you account for revenue, especially cost sharing, is pretty well laid out.

I could talk a little bit about R&D partnerships because that is the big deal in the pharmaceutical industry where, clearly, to give you sort of a framework of what I meant: a company like ours, we could at the time make a choice of saying, OK, we will establish the intellectual property in Ireland. We had a very large operation Ireland, the biggest, in fact, outside the United States. We had thousands of employees in the Republic of Ireland. And, of course, if you do that and you say, OK, the Irish entity owns the intellectual property, if the drug finally makes it, that is a fantastic answer because their corporate tax rate is 12 percent.

But the bad news is for somebody like me who, does not last forever, because CEOs normally last for 5 years, right? A few masochists like me did it for 17. In the short run, you do not get the deduction. So, obviously, if you did the same research in the United States, you get a full deduction as a legitimate business expense. But, of course, we did all that math and say presuming we win and we got the drug approved, that will still over a 20-year period be the right answer to position the intellectual property in this case in Ireland versus the United States.

Senator MCCASKILL. So the deductibility of expenses was not sufficient to overcome the hurdle of what you would gain once you made it across the finish line in terms of the tax rate on the profits?

Mr. PYOTT. That is right, 35 versus 12. There you go.

Senator MCCASKILL. There you go. Math again. Thank you.

Thank you, Mr. Chairman.

Senator PORTMAN. Thank you. Senator Lankford.

OPENING STATEMENT OF SENATOR LANKFORD

Senator LANKFORD. Mr. Pyott, let me continue on that same line on the intellectual property issue. Intellectual property, how is that connecting with the repatriation issues, territorial, worldwide system? Do you see that in the same vein? Do you see that as separating that out? How would you handle that? Because if you are dealing with the intellectual property issues and ownership, what

do you see as the best resolution on that specific issue? Then, Mr. Galvin, I have a question coming back to you on some of your math you were just doing as well.

Mr. PYOTT. Right. Well, at a very high level, I think, as I said before, resolving the headline tax rate is the real important thing. Around that, of course, there are other tools available that other countries have used, like the Netherlands, the United Kingdom in particular, on the innovation or patent box. And that will encourage where R&D takes place and where intellectual property is located. And, of course, just as I said before, once you know exactly what the rules are, then our peoples' job is to set up a stream of numbers where you decide what is the best answer for that particular program and your own particular corporation.

Senator LANKFORD. It does, but we are in this race that we are currently standing still while everyone else is running on the tax issues, when other countries drop their corporate rate and try to encourage people to come. We are in the same race on intellectual property as people continue to find innovative ways to be able to encourage R&D to happen in their country while we are standing still in it. So I guess the nature of my question is: What can we do as a Nation to encourage R&D to be here beyond just the rate itself?

Mr. PYOTT. In addition to rate?

Senator LANKFORD. Yes.

Mr. PYOTT. I think a patent box would be helpful. It is not the solution. It would be a palliative or an aid.

I think, earlier we heard from, in Senator McCaskill's remarks, we have, thank goodness, still have some huge inherent advantages in the United States. And in our industry; pharmaceutical, biotech, most innovations occur here, and in my view, that is due to the knowledge base that we have, which is due to the country's investment in National Institute of Health (NIH), in great universities, and then the whole financial system to enable startup companies to find capital and——

Senator LANKFORD. Right, but that is the asset side of it.

Mr. PYOTT. The liability.

Senator LANKFORD. The liability side of this.

Mr. PYOTT. Yes, yes. So I think what I am trying to answer is to say, first and foremost, it has got to be rate. And then I think after that you can probably bridge some numbers, you know, if there is a difference between—I will toss out numbers—a 30-percent rate and a 25-percent rate by using these other tools, you can tilt the advantage back in the favor of the United States.

Senator LANKFORD. Mr. Galvin, let me ask you a question about rates as well. There has been a lot of conversation about 25-percent rate and how that ends up being this normative rate in multiple countries. But you are also talking about countries that may be 12 percent, 2 percent, whatever it may be, to try to compete there, intentionally setting a corporate rate low, where their individual rates may be much higher, but their corporate rate is low intentionally to target companies.

So the question I have is: If we get a rate down to 25 percent, which has been discussed, or whatever that may be for a corporate rate, that does not really solve the problem, it does not seem like.

Mr. GALVIN. It makes a significant improvement in the situation. So if you could get the corporate or business tax rate—and I will use "business" rather than look at the legal entity, C corporations and everything else. If you made the business tax rate 25 percent and you put in place a territorial system that is similar to the vast majority of our competitive countries, you would find that we would not have the significant disadvantage that we currently have.

Also, as you look at intellectual property, all those other countries also, in addition to those lower rates, a territorial system, do have large R&D incentives. So you need a tax system that is competitive with the rest of the world. Certainly you are not going to get a rate or should not try, I do not think, to get a rate to 12 percent because there are a lot of potential problems if you have the rate there, because then other countries would just continue to follow it down. We need a rate that is just competitive with the vast majority of our competition.

Senator LANKFORD. OK. So I would tell you just my American attitude screams at me when I say let us try to get down to average. I like to win. Right now we are losing because we are at this rate that is noncompetitive. But dropping it to average does not seem exciting to me. How do we win in this, obviously not trying to shoot ourselves in the foot in the process, but to incentivize businesses to be able to be here rather than just say if we get to average, maybe we will not lose as many. I do not want to just lose as many. I want to win.

Mr. GALVIN. I think if you look at—because taxes are only one aspect of the manufacturing, technology, employment issues that you have. If you drop the rate further, as we did in 1986, the last time, we saw the other countries just brought it down even more. So if, for lack of a better term, you want to create a price war, which generally——

Senator LANKFORD. Which we are already in.

Mr. GALVIN. Yes, but be competitive at least. You have to match prices in the markets that you serve. If you do not, your volume goes down tremendously. That is what we are experiencing. If you drop it to 12, I do not know how long other countries, which have other levers to pull, will not just do the same and you have not accomplished anything.

Senator LANKFORD. OK. Fair enough. Can I ask about debt financing as well and the strategy and the advantages that foreign companies have in trying to compete to buy American businesses based on debt financing in that process? Do you have any insight on that?

Mr. GALVIN. Yes. I would say an example is the United States has fairly liberal thin cap rules on acquisitions, as I think some of the other panelists suggested, that when the companies were acquiring them, they used a lot of debt financing. And as you look at other countries as to debt financing in acquisitions, in studying the rules, other countries tend to use other instruments besides their tax laws to prevent the debt financing.

When we tried to acquire a company in China, which we did, for $750 million, we were trying to look at some debt financing because it generated—this was in 2000—a lot of cash and you could pay it off. The tax law would say you could do debt financing, but their

equity investments and other controls within China said it all had to be equity. So we had to put in $750 million of equity.

If you look at the French tax code, it is fine to have debt financing. But if you look at what they would say are transfer pricing on inter-company loans, it precludes it.

So we have, in my opinion, weak thin cap rules, and for a company—go back to a Missouri company that I am sure Senator McCaskill is quite close to, with Anheuser-Busch—and I think, Mr. Koch, you have probably heard of that company. The amount of debt financing that was used in that transaction was substantially significant, and they were able to finance it——

Senator MCCASKILL. Just say "huge." [Laughter.]

Mr. GALVIN. Yes, it was a huge number. It was a very big number. And what you had then is companies not only—the acquirer likes to put all this debt in the United States where you get the benefit of a 35-percent tax shield of all the operating profit of Anheuser-Busch. And so it is another case of where—if you are a capitalist around the world, where would you rather have your debt located? In Ireland at 12 percent, in Germany and most of the developed at 25, or in the United States at 35 percent? You would load it all into the United States. That is what they do. They acquire the companies, and they lever it up. Then when you see also what happens, which being familiar in the St. Louis community, the amount of job losses that occur are significant. When the U.S. companies are acquired, jobs in the corporate and also manufacturing locations, the R&D location, you lose jobs. No one likes that. That is what the Tax Code does.

Senator LANKFORD. OK. Thank you.

Senator PORTMAN. Senator Johnson.

Chairman JOHNSON. Thank you, Mr. Chairman.

I want to pick up on the point you just made, because I make a similar point in terms of where do you want to load up your operating profit. If you are a global manufacturer and you want to take advantage of what I think we have in terms of global advantages, competitor advantages, we are the world's largest market here in the United States, right? I came from a manufacturing background. I know manufacturers want to be close to the customers, so that is an enormous advantage. Plus we have abundant and relatively cheap power. So if you are one of those global manufacturers, you want to come manufacture close to the world's largest customer with cheap energy, are you going to site your plant in Toronto at 15 percent or Detroit at 35 percent? Isn't that what we are talking about? So you are going to want to site your operating profit or locate your profit in low-tax zones, and you are going to put your debt in a high-tax zone. Correct.

Mr. GALVIN. Yes.

Chairman JOHNSON. I want to talk about the total decision, because we are always talking about a territorial versus a worldwide system, which is a problem, traps profit overseas. But then we also have tax rates.

Mr. Koch, you talked about—and I thought it was a very powerful figure—that for every dollar of profit under U.S. ownership, you get to keep 62 cents; under foreign ownership, you would keep 72

cents. So that is a combination, though, of not only a territorial system but also tax rates. Correct?

Mr. KOCH. For us, we keep everything simple. We report every dollar of income in the United States.

Chairman JOHNSON. Right.

Mr. KOCH. So the territorial thing does not really affect us.

Chairman JOHNSON. But it affects any other decision here.

Mr. KOCH. Absolutely.

Chairman JOHNSON. It is a combination of the two factors. It is really difficult to separate both of them out. Is that basically correct?

Mr. GALVIN. Yes, and I would give you an example, that for Emerson, with 58 percent of our sales outside the United States, more than 50 percent of our profits are in the United States. And if you look at our sales and exports, we export from the United States to trade customers and to our internationally owned subsidiaries $1.6 billion more from the U.S. abroad than we export from those own subsidiaries back to customers in the United States. So, yes, you make other decisions as well.

Chairman JOHNSON. Mr. Koch, you are largely a family owned business still?

Mr. KOCH. Yes.

Chairman JOHNSON. What is your ownership in terms of outside?

Mr. KOCH. We are a publicly traded company, but the publicly traded shares are non-voting shares. And then I have about 30 percent economic interest, and that is all the voting shares.

Chairman JOHNSON. So, again, as an individual, as a patriot, you are saying, "I do not care about the 10 cents. I am going to keep the business here, and I will pay that 10 cents on every dollar penalty."

But I want to go to a public company, and the fiduciary responsibility of a CEO and the board of directors that are reporting to shareholders, which are unions and everybody else, and the pressure and, quite honestly, the fiduciary responsibility they cannot give up that 10 cents, can they? Mr. Pyott.

Mr. PYOTT. Yes, exactly. So that is why, U.S. multinationals, as we heard, do appropriate tax planning following the rules. And in our case, I would say we were maybe just over the middle of the pack, where we paid 26 percent worldwide effective tax rate, in our case, with 40 percent of our sales being outside the United States. And I can certainly say in terms of the locus of decision of where to manufacture, clearly for a long period of time, 25 years plus, we invested most of our non-U.S. capacity into Ireland because, obviously, a good workforce, well educated, hardworking, and a tax rate—and given our kind of business, where, you are selling eye drops in a little bottle of 5 or 10 ml., freight costs really do not play any role at all.

Chairman JOHNSON. Now, what Senator McCaskill was saying, people that run these large corporations can do the math. But, again, they also have that fiduciary responsibility. But it is way more than just making a decision or being a patriot. It is about being able to compete, correct? If you do not make that decision, if you take that 10-cent-per-dollar penalty, or even greater, eventu-

ally you will not be able to compete, and then you will lose jobs. Is that basically a correct evaluation?

Mr. PYOTT. That would be true. In our case, I think we were so strong that we were able to overcome the tax disadvantage because we had innovated. And, again, when I started, we were a very small firm. It was less than $1 billion. And we competed against large U.S. multinationals—Pfizer, Merck—and people used to say, "How will you survive?" Well, happily, we were so focused in eye care that both those companies for different reasons left that business, and we were the ones that prevailed and gained market share year in, year out.

Chairman JOHNSON. Well, eventually you were not able to survive as a U.S.-owned company. That is the bottom line. Again, we can demonize those individuals that took a look at the Tax Code—and, again, if there was insider trading, that is a totally different subject. But let us assume there was not. But those—we will call them "corporate raiders"—they are simply using a Tax Code and looking at global tax jurisdictions and saying this is a financial transaction that makes a lot of sense, and there was in the end nothing you could really do about it, other than find a white knight——

Mr. PYOTT. Which happened to be a foreign——

Chairman JOHNSON. A foreign company, because, again, that is the only way they could compete.

Mr. PYOTT. That is right.

Chairman JOHNSON. So this is about math, this is about competition. And, again, we can demonize American companies that are trying to survive, which is the wrong way of looking at this, or we can take a look and, as the Chairman said, point to the real villain, which is the Tax Code, which forces this. And, again, if we ignore that reality—and that is what I want to get to. The reality of the situation is we have an uncompetitive Tax Code, and if U.S. businesses do not respond to that, they will be put out of business because they will not be able to compete. Is that basically a true statement, Mr. Galvin.

Mr. GALVIN. Yes.

Mr. PYOTT. I would like to follow on to what you really suggested, and that is, companies that are either foreign or have become foreign through the inversion process typically have then used that hunting license and that advantage to keep going. And there are many examples where the original transaction was, let us call it, $10 billion, and 4 or 5 years later, the quantity of deals they had done was multiples of that, three, four, or five times. So you can see there is a secondary effect here as well.

Chairman JOHNSON. OK. I will just close, again, by commending the Chair and Ranking Member. This is so important. Senator Lankford just left. He is in charge of our Subcommittee on Regulation, which is another big problem when you are trying to track global capital and keep manufacturing jobs in America. We have such an uncompetitive regulatory environment. But as this hearing clearly shows, as the work of this Committee staff has done, and the Chairman and the Ranking Member have done, we have an uncompetitive tax system forcing companies, in order to survive, to take over that corporate ownership, and then we lose it all. We lose

all the income in terms of being able to tax it. So we have to become far more competitive, and we are highlighting a reality here that we have to admit exists.

Thank you, Mr. Chairman.

Senator PORTMAN. Senator Ayotte.

OPENING STATEMENT OF SENATOR AYOTTE

Senator AYOTTE. I want to thank the Chair. I want to thank the witnesses that are here. This is a very important topic. But I kind of want to boil this down to a little straight talk on this, because I think what we are seeing in the political realm is we have seen a lot of discussion about bad corporations who want to commit these horrible things called "inversions." When we think about the workforce, the people of this country that want a good-paying job in this country, isn't it those individuals who get impacted the most by our failure to take on this Tax Code issue and make sure that we are competitive? And I would ask each of you for a yes or no answer on that. Mr. Galvin.

Mr. GALVIN. It is very difficult, how you phrased the question, to give a yes or no answer, because there are two types of transactions you proposed or looked at. If you are looking at corporate acquisitions from an international company buying a U.S. company, the employment levels I think factually will show you have been substantially reduced. I think you can see that very clearly in the Anheuser-Busch situation.

If you look at inversions, we are seeing a lot of inversions, and I do not have the numbers in front of me, but I suspect the management generally does not move from the U.S. location where they are at. A few people, it is a domiciled location in another country. The community involvement in an inversion probably still remains very heavily in the U.S. So you have a different impact on an inversion with a management, even though they acquired another company and a new company is set up, the legal ownership—and there are probably several more lawyers here than I am, but that legal ownership is abroad, the management who is running it is probably——

Senator AYOTTE. I am just trying to boil this down for my constituents to understand. Competitiveness, incredibly important. What I get the question from your average person is, OK, I see these corporations, the management, the leadership, they are doing very well. How do we make sure that the people in this country that are struggling, the middle class, that we create greater opportunities for them? And it seems to me that this Tax Code issue often gets misrepresented, that somehow if we make our code rate more competitive, if we make sure that we have the right types of laws to encourage research and development, whether it is a patent box or something, ultimately, it is the workforce that is going to benefit in terms of opportunity. And that is what I am trying to get at, because this is a question I will get out at my town halls when it comes to the corporate rate and why should we do this, aren't we giving an advantage, to people that are doing well anyway. And I just want to boil this down so that your average person can understand why this is so important.

Mr. PYOTT. Maybe if I can have a stab at it, if one looks at history around the world—and I am fortunate. I have lived in 10 countries, worked in 7, so I could tell you the good, bad, and ugly of all of them. And if you look, say, at extreme examples like the United Kingdom and Sweden in the 1970s, where we had completely uncompetitive taxes, probably uncompetitive labor markets, and business just left the country, once that got fixed, a lot of it came back. So that is very encouraging that in the same way that we are lamenting the current situation, if we can get it right, even if we were average, things would be a lot better.

I would also like to give you an example of creation of jobs. In my testimony I was talking about the huge investment in R&D. In my 17 years, I started with an investment of $100 million a year in R&D, and the last year was well over $1 billion. A large part of that was you need people to do that. You need highly educated people. Eighty percent, maybe 85 percent of those people were in the United States. They were not in the United Kingdom, France, Switzerland, or Singapore. They were in the United States. And, hence, why when my explanation of what occurred, the plan to really kill R&D, which is just factual, by Valeant to reduce the R&D spend from $1 billion down to $200 million-plus, you can work it out what would have happened. And I stated thank goodness the best answer I could get was the merger with Actavis, who at the margin is reducing R&D probably 12, 15 percent, again, not my desire, but we are all pragmatists. It was the best we could do. And it was the right thing for the future company and its stockholders.

Senator AYOTTE. Mr. Koch.

Mr. KOCH. Yes, I would add to what the other panelists have said. There is something different about American ownership of a company. I mean, you live in the community. You do not want to see in the paper that you just cut 1,000 jobs.

Senator AYOTTE. Right.

Mr. KOCH. But if you live in a foreign country and you fly in and you whack all those jobs, there is no remorse. But as an American-owned company, the people I employ, their kid, my wife may coach them on the soccer team, you see them at a—I mean, these are people you went to school with back in Cincinnati. It is important to provide a livelihood for those people, and you cannot get away from the personal commitment and desire to continue that comes from having the decisionmakers here in the United States in that community.

Senator AYOTTE. Well, I appreciate all of you being here. I think that you have given us a very obvious list of things we need to do. And this is something that we have been talking about a lot here collectively in the Congress for too long, because it is obvious what we need to do in terms of the tax rate, in terms of competition, in terms of making sure that this is the best place in the world to own a great American company that produces some really good beer.

And so I think that we, I hope that this is something we can work together across party lines on because it will help make sure that the 21st Century is an American century when it comes to American jobs. So I thank you all for being here.

Senator PORTMAN. Thank you, Senator Ayotte.

We are now into our second round of questions. We will try to keep these to 5 minutes for each of us. Many of the questions that you all have answers I think have shed light on this issue of how do you come up with a better tax system. We talked about the rate. We talked about the international system, territorial system, enabling countries to repatriate their profits, the U.S. system currently locking out those profits.

But on the jobs front, I am just curious. Mr. Galvin, I said I was not going to let you off the hook. I have some questions for you as well. You talked a little bit about Schneider outbidding you for APC, and this is in this category I talked about earlier where it is not just about U.S. companies getting taken over by foreign companies. It is about U.S. companies not being able to be as successful as they could be because when they try to grow, they are constrained because foreign entities can pay a higher price for that company because of their after-tax profits being better. They can pay a premium. And I think what you said was that this was an example.

So here is my second question, though, about APC. Do you know what happened to APC? They were taken over by Schneider. What happened to their U.S. job totals?

Mr. GALVIN. They went down substantially in Rhode Island, and a lot of the R&D was consolidated and leveraged in the French operations, which when you have an acquisition, there generally is a lot of leverage on that business.

We would have also reduced the Rhode Island employment, but we would have substantially moved those jobs to Columbus, Ohio, where we still own Liebert Corporation, which makes three-phase UPSs as opposed to single-phase and would have kept the workforce in the United States.

We both had a substantial share already in the UPS business, and we could both get substantial operational synergies in serving the world market. It would have been just us, would have moved it to a U.S. location, which is often where we have our centralized investments, so we still employ a lot of people in Ohio, as you know.

Senator PORTMAN. Now you have really piqued my interest by mentioning Ohio.

Mr. GALVIN. I thought I would.

Senator PORTMAN. We are part of this puzzle.

Senator MCCASKILL. That was convenient.

Senator PORTMAN. Thank you. [Laughter.]

So here we have a situation where you are trying to buy up companies so you can expand and grow your U.S. company. You lose out on the acquisition because of a foreign company can pay a higher price because they can pay a premium. They buy the company. This is a U.S. company that you wanted to buy. They do the smart tax planning, which is to take intellectual property, R&D, take it overseas, and the French do have a lower rate, and they have the ability to take advantage of that. They, therefore, take jobs out as well. David Pyott talked earlier about how R&D and jobs go together, and increasingly that is the case. I do not know, we have not really talked about the OECD Base Erosion and Profit Shifting (BEPS) project, but basically that is encouraging countries to go

ahead and say not only do we have a patent box, but we have a nexus where you have to have the actual business activity connected with it, meaning people.

So we lose jobs. You cannot expand, including in Columbus, Ohio, thank you. But it is almost a secondary cause that I think we do not focus on enough here, is that it is not just about U.S. companies being taken over. It is about U.S. companies not being able to be competitive. And this does go to salaries and wages and benefits, because that is who, in the end, bears the brunt of this, is the American worker. So thank you for your work on this project of tax reform over the years, Mr. Galvin, and we look forward to working with you going forward on trying to come up with a bipartisan approach that is sensible. Perhaps even in the next few months we can make progress on that.

Back to Mr. Pyott for a second with regard to this intellectual property issue. You talked about the fact that other countries are putting in place these patent boxes where they may have a lower rate than us but they have a substantially lower rate than us with regard to intellectual property that is often a patent or a copyright, and they define these differently. Senator McCaskill raised the good question earlier about a challenge for us as we look at patent boxes, and as you know, that is something that Senator Schumer and I recommended in our report a few weeks ago, is, what kind of intellectual property do you include? Obviously, you have a lot of experience with regard to the R&D side, on the pharma side, and with regard to patents. But do you have some thoughts for us with regard to if the United States were to go to a patent box, how broad the definition of innovation should be?

Mr. PYOTT. Yes, I think that is where you really get down into the real nitty-gritty details, and I think to answer on a high level, first of all, as I said earlier in my testimony, you can overcome a couple of hundred basis points of overall rate by making those kinds of tools available. In our case, as I was explaining, we often chose to think very carefully about where we would locate our intellectual property, understanding on the long swing we had a final good answer. But, of course, on the short swing, we were paying a lot more—it was costing more because we did not have the full 35-percent reduction. So that was a balancing act.

Senator PORTMAN. The deduction you would have had in the United States versus the——

Mr. PYOTT. If we had kept the intellectual property here.

Senator PORTMAN. Right. But the value of that IP grows as your drug may be successful.

Mr. PYOTT. That is right.

Senator PORTMAN. And, therefore, it is worth having it overseas.

Mr. PYOTT. Yes. I think also another one for us—and that gets back to the nexus you made between patent box and where the R&D actually gets done, let us use that word, where the real people sit, the real expenses are, because there, thank goodness, we still have a huge inherent advantage. We located most of our R&D in California, not just out of emotional love, but that is where the real knowledge was. And even in the United Kingdom, where we located our operation, there was access to the kind of people we needed, but let us say the real emphasis remained the United

States. And had we moved forward another 10 years the same way, I think it would have still stayed the same rough balance.

Senator PORTMAN. The final question I have is just briefly with regard to this inter-company lending. So what you told us this morning is not only does the rate matter, not only does the territorial system matter, but also that these foreign companies have an advantage because when they buy a U.S. company, they can load up debt in the United States, take advantage of the 35-percent rate and the deduction you get.

So this is something, obviously, that is a concern as you are looking at tax reform, and, Mr. Galvin, you have, I am sure, looked into this quite a bit. But one of the challenges that we have right now as we look at how do we come up with a new system is to try to avoid some of—the BEPS project gets into this, of course—some of the base erosion that might occur through inter-company debt. Can you talk about what you think might be the right answer to that?

Mr. GALVIN. Well, certainly a benefit in lowering the rate to 25 percent and having it competitive with the rest of the world would substantially reduce the incentive to load the debt in the United States.

Senator PORTMAN. Probably the best base erosion we could do is lowering the rate.

Mr. GALVIN. Yes, lower the rate, and they are not going to load up—if it is the same rate in Germany, France, Switzerland, whatever, you do not have the same incentive. You are incentivizing them economically to put the debt in the United States.

Senator PORTMAN. Senator McCaskill.

Senator MCCASKILL. So here is my worry about us really getting serious about redoing this Tax Code. I have had the pleasure or the horror of sitting in on some complicated tax planning meetings with some of the foremost tax experts in the country, and it is frightening. It is frightening because, for everything we do in the Tax Code, it is an action we take, but then there is a reaction. So you cannot just say, OK, we are going to do 25 percent and then let it go. We have to do all of the other stuff. I mean, if you just look at the interplay between estate taxes and trusts, for example, and all of the things that good tax planners can do around those two things, that is just one example of thousands that are in the Tax Code.

So I would certainly ask all of you, those of you who have had real-world experience with complex financial, international transactions, to be all hands on deck helping us here so that we can look around corners.

What we just talked about in terms of the patent box, if we do something like a patent box, do we require, for example, Mr. Pyott, that in order to take advantage of the patent box, you must do the R&D in the same country? In other words, if you are going to get the patent deal here, you cannot just have the IP located here; you have to do all the R&D here, too. Is that a good idea? Is that a bad idea? Are we going to have a reaction that is not good there? What is your opinion on that?

Mr. PYOTT. I think that would be very sound for the United States given our strength in R&D and our whole background of huge investment in the NIH, which is a national jewel, as well as

all the benefits that then spill into startup companies, universities and so on. That takes decades to replicate.

And if I were hypothetically, in the U.S. Government, I would say make that an item of trade negotiation as well, to say to our partners in the OECD, "Fine, we are good with your patent boxes, but you have to have a level playing field," i.e., make the nexus, the expenses, the people have to be where the patent——

Senator MCCASKILL. Require the nexus for them also as part of trade.

Mr. PYOTT. That is what I would say.

I will give you another example in the discussion that we did not touch upon, and that was the Treasury regulation that was put out last September to tighten up the rules on so-called hopscotching of foreign-located cash. And, again, I think that was a useful measure, but as I said in pretty much all my testimony, these are things that are at the edge. But if you get them all right in the cumulation, then it will be really quite good. Or I think with Mr. Galvin, when I was listening to you, if you have rules about how much debt can you put down, to prevent, let us call it, certain limits being exceeded, those are all things—if you just get them, like 10 of those things broadly right, then you have probably got the whole thing broadly right.

Senator MCCASKILL. I was interested to hear you say that your R&D went to California, and the reason that interested me is because around here California by some of my colleagues would be considered the worst place for a business to go because all the regulation in California and the taxes are so high and the regulation is so awful. So the magnet was, in fact, the higher education community and the knowledge base that is in California?

Mr. PYOTT. That is still our inherent advantage. Now, to be fair, the company was founded in California in 1950, started in L.A., went down to Irvine before the city even existed. I celebrated with the mayor 2 years ago, 50 years of Irvine, and I pointed out, "We were here before you were," which was kind of fun.

But the real point that you make, I totally agree with you. It is the basis of people that are being produced by the UC system, CSU, which we need to, by the way, pay attention to because funding is disappearing from the University of California, and then all the startup companies. It is a whole fabric, a tapestry of people, venture capitalists, that is very difficult to replicate. And, you see it happening in other areas of the United States, but, really when you step back, you can say the biotech industry is really Northern even more than Southern California, more San Diego than Orange County. It is the Boston area, a little bit in Maryland. And then the device industry is very much Boston, Minnesota, and California.

I mean, there are notable exceptions, but those are the real clusters. And, if anything, I see people moving more to the clusters than moving away from them despite cost.

Senator MCCASKILL. So I think the point I am trying to make here is it is just not as simple as the number. The math matters and being competitive matters. I could not agree more. But if we in the effort to lower the corporate tax rate erode our revenues we have done NIH on the cheap ever since the crisis. NIH has been

struggling. Government shutdowns are brutal to NIH because of the inability to have certainty in terms of funding research, which you cannot do in fits and starts and do it effectively, certainly not cost-effectively.

So I just want to make the point, I think the hardest thing for us on tax reform is the partisan divide that we have, that we try to navigate around. And the Chairman and I are, I hope, part of a group that is working very hard to tear that down. But I think it is important for the business community to continue to stress that higher education in this country, funding of NIH, the ability of our kids to afford college, that all of these are just as important for our global competitiveness as the number that we stick in the Tax Code. And I hope that all of you will help us with that, and particularly, Mr. Galvin, I know your leadership role in BRT and the business leaders. It would be a shame if we would, have a race to the bottom on what is our inherent strength in a foolish race to be the lowest tax rate in the world.

Thank you, Mr. Chairman.

Senator PORTMAN. I thank the Ranking Member, Senator McCaskill, and I just have to say the Joint Tax Committee in 2013 did a great analysis, saying if you get the rate down to 25 percent, you actually get more revenue because you have more economic activity. And that is the goal, obviously, that all of us have, is to bring these jobs and investment back and to generate more opportunity here.

Gentlemen, thank you very much for your testimony this morning. We will now call the second panel. Thank you for being here.

[Pause.]

Senator PORTMAN. OK. We will call our second round of witnesses now for this morning's hearing, and I want to start by thanking both Mr. Schiller and Mr. Kobza for being here. And I also want to thank them for their cooperation and their companies' cooperation with the Subcommittee. They voluntarily provided very important information that helps us to get to the bottom of what we are after here, which is better tax policy. And I appreciate their willingness to do that.

I also want to repeat what I said earlier today, which is that we are talking here about the U.S. Tax Code being the problem. OK? And I hope that is something that every person watching or listening today understands. This is about a problem here in Washington, D.C., which is a Tax Code that is dysfunctional. It is not serving American workers. It is antiquated, it is outdated, and it has to be more competitive.

Mr. Schiller served as Valeant Pharmaceuticals' chief financial officer between December 2011 and June 2015; therefore, he has a lot of experience and background that will be helpful to us.

Joshua Kobza is the chief financial officer of Restaurant Brands International, which is the parent company of Burger King and Tim Hortons, the Canadian restaurant chain.

I appreciate, again, both of you being here this morning and look forward to your testimony. We do have a time system, which we talked about earlier. We would ask that you try to limit your oral testimony to 5 minutes. Of course, all of your written testimony

will be printed in the record, and we look forward to the opportunity to ask some questions afterwards. Mr. Schiller.

TESTIMONY OF HOWARD B. SCHILLER,[1] CHIEF FINANCIAL OFFICER (DECEMBER 2011–JUNE 2015), AND BOARD OF DIRECTORS (SEPTEMBER 2012–PRESENT), VALEANT PHARMACEUTICALS INTERNATIONAL, INC.

Mr. SCHILLER. Chairman Portman, Ranking Member McCaskill, and Members of the Subcommittee, thank you for the opportunity to appear before you on behalf of Valeant Pharmaceuticals.

Valeant is a multinational specialty pharmaceutical and medical device company. We operate in over 100 countries with approximately 45 percent of our revenue in 2014 coming from outside the United States, with a particular focus on growing emerging markets.

For the past 7 years, Valeant has employed and successfully executed on a unique and differentiated business strategy within the pharmaceutical industry. Today's Valeant was born of the 2010 combination of Biovail, a Canadian corporation, and Valeant, a Delaware corporation. At the time, each of Valeant and Biovail were small pharmaceutical companies focusing on many of the same therapeutic areas and geographies, with the need for greater scale to compete against larger multinational pharmaceutical companies. This was a merger of equals in which Biovail acquired Valeant. Today we are headquartered in Laval, Quebec, and have approximately 19,500 employees, approximately 5,700 of whom are based in the United States.

Over the past 5 years, our sales and market capitalization have each grown tenfold to projected 2015 sales of approximately $11 billion and a market capitalization of approximately $87 billion. With this growth, we have been able to expand our operations both here in the United States and around the world, creating quality jobs in the markets in which we operate.

The growth and success we have been able to achieve at Valeant is rooted, we believe, in the values and core principles that guide our business decisions. These include:

First, a commitment to the health and safety of the patients and customers who use and rely on our products.

Second, a commitment to innovation through an output-driven R&D approach, which is unique in our industry. We focus less on how much we spend on R&D and more on what we get out of our R&D efforts. We source innovation through internal efforts, through licensing technologies from entrepreneurs and other third parties, and through acquisitions. We believe the results of this approach speak for themselves, with 20 product launches in the United States alone last year and a rich pipeline of products.

Third, a commitment to our decentralized business model under which each business unit is given control over and held accountable for results within that unit.

Fourth, we are committed to a disciplined approach to business development with a focus on high rates of return and rapid pay-

[1] The prepared statement of Mr. Schiller appears in the Appendix on page 57.

back periods for our shareholders. I would like to address that last principle in greater detail.

First and foremost, we only pursue transactions that make strategic business sense for Valeant. We generally look for businesses to complement our existing product portfolio and/or match our focus on high-growth therapeutic areas of geographies where we believe we can improve business operations. We have a strong track record of deploying our management and business strategy to grow and improve businesses we acquire and provide superior returns to our stakeholders.

Second, we take a financially disciplined approach to business development. When assessing acquisition opportunities, we generally seek to achieve at least a 20-percent internal rate of return and a payback period of 6 years or less based on applying statutory tax rates to the projected future earnings of potential targets. Of course, these are guidelines, not hard-and-fast rules, and every acquisition involves a significant element of judgment. In particular, as we have previously stated in public statements to our shareholders, with respect to large public company acquisitions, due to the transparency of the public markets and other factors, we have generally accepted rates of return below our stated targets based on our ability to deploy large amounts of capital at returns still significantly in excess of our cost of capital.

We do not value proposed transactions and do not decide whether or at what price to acquire a business based on the availability to achieve tax synergies. We do, however, enjoy a lower overall tax rate which allows us to generate more cash-flow for a given dollar of revenue and leaves us with more capital to deploy in our business, which in turn allows us to deliver higher returns to our shareholders and accelerate our growth.

Ultimately, while the tax synergies we have been able to achieve have certainly helped us deliver value to our shareholders, we believe that the execution of our differentiated business model has been the primary source of our growth and success. Our financial guidelines have helped us to stay disciplined in our acquisitions strategy, and as our Chairman and CEO indicated last week in an earning calls reviewing past deals, we are exceeding our expectations with respect to our acquisitions overall.

You have also inquired about our views regarding U.S. tax reform. I am not a tax expert and cannot speak to the specifics of any particular aspects of tax reform, but we have found the Canadian system to be very conducive to our growth and success. I would be happy to elaborate on that further during Q&A.

Thank you again for the opportunity to appear before the Subcommittee, and I would be pleased to answer questions regarding these topics.

Senator PORTMAN. Thank you. Mr. Kobza.

TESTIMONY OF JOSHUA KOBZA,[1] CHIEF FINANCIAL OFFICER, RESTAURANT BRANDS INTERNATIONAL

Mr. KOBZA. Thank you. Chairman Portman, Ranking Member McCaskill, and Members of the Subcommittee, thank you for the opportunity to appear before this Committee. My name is Josh Kobza. I am Chief Financial Officer of Restaurant Brands International (RBI) and most recently worked in the same capacity at Burger King Worldwide. I am here today to discuss the recent Burger King-Tim Hortons transaction, which created one of the world's largest "quick service restaurant (QSR)," chains. I understand that the Committee is reviewing the tax effect of the corporate Tax Code on U.S. businesses and on cross-border mergers and acquisitions. While this transaction, like all cross-border combinations, had certain tax implications, the marriage of these two iconic brands of similar size under the RBI umbrella was motivated by compelling business reasons rather than tax strategies.

Our vision centered on combining two brands that occupy a distinct space in the QSR landscape—both geographically and in their menu offerings—to create new opportunities. Burger King is the world's second largest fast food hamburger restaurant, with over 14,000 restaurants in approximately 100 countries and U.S. territories.

Tim Hortons is the largest Canadian-based QSR, with approximately 45 percent of all QSR traffic in Canada.

Our new RBI family now includes over 19,000 restaurants in approximately 100 countries. More than half of Burger King's restaurants are located outside the United States, and we see a significant opportunity to grow the Tim Hortons brand and unique operating model in attractive markets all around the world, beginning in the United States.

My testimony today focuses on this transaction as it occurred rather than hypothetical scenarios that could have any number of potential inputs and points of analysis.

In 2013, our management team began to evaluate future alternatives for growth and enhancement of shareholder value, including potential strategic transactions. Through our search, we identified Tim Hortons as an excellent choice—a very high quality business with an incredibly strong brand and complementary menu offerings, where we could add significant value by leveraging Burger King's worldwide operating partner networks and experience in global development.

We structured the transaction in a way that honors the history of both companies. Burger King's headquarters remains in Miami, Florida, and Tim Hortons' remains in Oakville, Ontario, with separate management to ensure the integrity of each brand.

We plan to open hundreds of new Tim Hortons restaurants across the United States, attracting tens of millions of dollars in investment, creating thousands of new jobs, and expanding the U.S. tax base.

As CFO during discussions between Burger King and Tim Hortons, I was responsible for working with our professional advisers to explore how to structure a potential transaction. As these discus-

[1] The prepared statement of Mr. Kobza appears in the Appendix on page 70.

sions progressed, it became clear that a combined Burger King-Tim Hortons company should be domiciled in Canada.

The business case for this transaction was always very clear to us, and closing the deal required careful calibration of the terms and structure of the transaction. Both the Tim Hortons brand and the Burger King brand are revered institutions in their country of origin. But given that Canada is the country with the highest concentration of employees, assets, and income for the combined company, Canada was the logical choice to be the domicile of the newly formed entity.

Additionally, the Board of Directors for Tim Hortons at first declined to discuss any possible combination and was reluctant to engage in serious negotiations until our proposal contained both a higher price and a commitment to locating the combined company in Canada. Throughout our discussions with the company's board and management, it was made clear to us that domiciling the company in Canada was critical to concluding a deal.

Under the transaction, Burger King remains a U.S. taxpayer with an unwavering commitment to our Miami headquarters, the surrounding community, and our U.S. franchisees. When compared to the 26-percent effective tax rate paid by Burger King prior to the transaction, our current effective tax rate is only slightly lower—in the range of 3-percent reduction. This modest impact underscores a crucial point: Joining Burger King and Tim Hortons together was fundamentally about growth. Tax considerations were never the driving force for our transaction. Rather, our primary motivation was to realize the greater business potential of combining these two iconic and complementary brands.

That is not to say that the domiciling of the company in Canada did not have any tax effects. Canada's tax regime provided both slightly better rates and its quasi-territorial system provided an efficient and attractive platform for growth. As a combined company, we are focused on accelerating our growth. Our goal is to grow our business and our brands alongside our franchisees, employees, and other partners.

In closing, we understand that in recent years, the policy discussion regarding the role of tax considerations in corporate mergers and acquisitions has become more prevalent. In this regard, we welcome the ongoing bipartisan efforts to make the U.S. tax system more competitive to level the playing field.

Again, thank you for the opportunity to appear before this Committee. I look forward to answering your questions.

Senator PORTMAN. Thank you both very much.

I am going to start with you, Mr. Kobza, and Burger King. You just made a point that the territorial system in Canada helped with growth, that you have a slightly better rate in Canada. The information you provided us with regard to your decision-making was interesting to me, in part because of what you said about the difficulty of bringing your profits back to the United States. You all were growing internationally. You wanted to grow more, and that is a good thing. But you found that it was hard to bring those rates back.

Could you turn to page 29 of the appendix? I think you have that in front of you there.

Talk to us a little about this. Is it accurate to say that at the time of the transaction you expected a lot of your future growth to come from international expansion?

Mr. KOBZA. So prior to the transaction, we had gone through 4 years of rapidly accelerating development around the world. I think one of the great accomplishments of those 4 years was to multiply the pace of our growth by about four times in terms of net new restaurants.

Senator PORTMAN. So you were looking to grow more internationally. So here you are, a U.S. company wanting to grow internationally. And what were you facing internationally? You had, again, looking at the data you provided us, about $700 million locked out in foreign earnings, meaning earnings you could not bring back to the United States without paying a high tax rate. Is that accurate?

Mr. KOBZA. It is accurate that we had about $700 million of permanently reinvested earnings, and we had made the decision prior to the transaction that we would reinvest those permanently, whether that be through new investments in our growth or through M&A, or investments in our joint ventures.

Senator PORTMAN. And what were you telling your board that your corporate rate would be if you brought those cash balances you had overseas, that $700 million, back to the United States of America? What was your tax rate you talked about? If you look at the appendix, there is a number there.

Mr. KOBZA. Yes, I think it is very helpful to look at page 10 of the appendix, and I think it is very important to bring some context to this page. This is really fundamentally the lens that we look through when we analyzed the merger with Tim Hortons. And what you have on the left side of the page is our base case outlook, which considered our strategic plan for the existing Burger King business and our existing tax rate, which was around 28, 29 percent. And we thought that with that plan we could generate a share price of about $46 over the course of the next few years.

So when we measured the incremental value that this merger would add, we always looked at it versus that $46 per share. So we looked at how much more value could we add by doing the merger.

Senator PORTMAN. Let me just focus you in on this one issue, though, that we are getting at, and I appreciate your comment earlier that you hope we could see a U.S. Tax Code that was a more level playing field. You had $700 million overseas. You were telling folks that under the corporate structure of being a U.S. company, if you brought that back, it would be a very high rate. In fact, I think you said it would likely increase to near 40 percent would be your corporate tax rate if you were to repatriate those cash balances. Is that correct?

Mr. KOBZA. The reason for that analysis was that when we looked at a Canadian-domiciled company, we considered that given the quasi-territorial system, we would likely distribute all of our foreign earnings. So as an illustrative analysis, we calculated at a very high level what the tax impact would be if we were to distribute all of our earnings in the existing case, and we used an illustrative rate of 40 percent, and that is the value that you see on——

Senator PORTMAN. I get it. And that is sort of the point, in part, of this hearing, to say here you were a U.S. company and saying you would like to have the flexibility to be able to bring some of those profits back and reinvest here and expand, and you probably also thought this is going to get worse because you wanted to grow more internationally and, therefore, have more of those earnings that would get into this lockout. So, there was a tax barrier.

The other issue is how did you choose Canada as your headquarters, and let me preface this by saying I do not question what you are saying at all about the business reasons to have the combination. I think, from everything I have read and heard about it, that is what motivated you looking at Tim Hortons in the first place, and it sounds like it is working for you from a business perspective.

But you had a decision to make. Where is the headquarters going to be? And my understanding is that—and, again, I think this is—if you look at page 25 of the appendix, you will see something with regard to this decisionmaking as to where the headquarters ought to be. You looked at a number of different places. I do not see the United States of America on the list. And I assume, based on the information that you provided us, that that was because of the tax consequences.

So I get it that Tim Hortons wanted to stay in Canada. I am sure they had lots of reasons for that, maybe some of which had nothing to do with taxes, but certainly one would be taxes. Is it accurate to say that the United States was not even on the list of places where you might want to put a corporate headquarters of the combined companies?

Mr. KOBZA. Yes, so as we went through the transaction, I would say there are probably three big factors that drove our decisionmaking about why the combined company should be domiciled in Canada.

First, Canada would be the center of operations for the combined company. It had the largest concentration of employees, assets, and income of the company.

And the second reason is that this was something extremely important to the board of directors and management team of Tim Hortons. And, in fact, in written communications to us, it was put out as a condition to moving forward and even beginning to negotiate in the deal. It was only after we put that in our offer letter that the company even began to negotiate with us.

Furthermore, we had to count on getting approval from the Canadian Government under the Investment Canada Act (ICA), and we went through a study of all 1,500 cases that have passed through ICA review in the past 25 years and through that study came to the conclusion that domiciling the combined company in Canada would be a critical success factor for getting through that approval process. And we did not have any exit from the merger agreement if we did not get approval, except under extreme circumstances and in which case we would have had to pay a $500 million penalty. So those three factors were very strong factors in driving us to consider Canada.

That said, we also looked at the tax effects of domiciling the company in Canada, and as you can see from the materials, there was

a reduction in the tax rate relative to the tax rate that Burger King was paying previously, and that is something that was factored into our analysis, into our board's analysis of the deal as a whole.

Senator PORTMAN. One final one is just with regard to, again, page 25 of the appendix. The slide seems to be saying that Burger King moving offshore would reduce your tax rate to the low 20s and avoid this 40-percent effective rate we talked about if you had had to bring your earnings back from overseas. And you say here that the incremental value creation from tax savings would be $1.4 billion without repatriated earnings and $5.5 billion if you did repatriate. So assuming repatriation, which your presentation does, was it your estimate at the time that placing the combined company headquarters in the United States would have destroyed about $5.5 billion of value?

Mr. KOBZA. So the $5.5 billion calculation was a very simplistic, high-level, and illustrative calculation that applied that rate to the combined company. Because of the fact that we only ever looked in-depth and explored with our advisers in-depth the tax structuring among other structuring considerations of a transaction moving to Canada, we never looked in-depth at fully examining the impacts of domiciling the company in the United States

Senator PORTMAN. So it is an estimate.

Mr. KOBZA. It is a very high level estimate.

Senator PORTMAN. But a significant one; $5.5 billion in a transaction of this size obviously played a huge role.

So, look, thank you again for your willingness to provide information. We appreciate the fact that the information you provided us is helping us to come up with, as you said earlier, a better tax system.

And with that, I will turn to my colleague, and I look forward to following up with questions in a moment. Senator McCaskill.

Senator MCCASKILL. Thank you.

Mr. Schiller, there was a press release at the time that you were fighting for Allergan from Allergan about your tax strategies being more aggressive than many of your peers' within the pharmaceutical industry. In 2014, the CEO, Michael Pearson, stated, and I am quoting: "We were able to get a corporate tax structure which took our effective tax from 36 percent overall to one that was actually 3.1 percent, which we hoped to continue to work on and move lower."

Do you understand how that infuriates Americans? I mean, I get it that it is the math, and I get it that it is legal. But you understand the notion that a corporation as large as yours that—and I think you said in your testimony the majority of your sales are to Americans? The majority of your profits are from Americans? That you believe you can figure out a way to pay less than 3.1 percent in taxes when most Americans are going, "What is up with that? How did we get to that situation?"

How much lower do you think you could get the rate than 3.1 percent? Nothing? I mean, do you believe that you have an opportunity to get—are there ways you are strategizing that you can—is your rate at 3.1 now, your overall rate?

Mr. SCHILLER. No. Our rate right now is around 4 percent.

Senator MCCASKILL. It is at 4, OK. Well, let me ask you this: What percentage of the profit that you are generating in Valeant comes from Medicare?

Mr. SCHILLER. We have a very small percentage of our profits—I believe—of our revenue. I believe it is around 5 percent or so that is government, either Medicaid or Medicare.

Senator MCCASKILL. OK. Well, let us talk about Isuprel. It is a drug to treat cardiac arrest, so I am assuming that a large number of the people who would take this drug would be over 65.

Mr. SCHILLER. Yes.

Senator MCCASKILL. In 2013, a company called Hospira sold Isuprel to Marathon Pharmaceutical, which increased the price from $44.50 per vial to $215 per vial. Do you know how much Isuprel is paid for by Medicare in the United States?

Mr. SCHILLER. I do not know specifically.

Senator MCCASKILL. Well, I would really appreciate if you all could get us those numbers for Isuprel, because in February of this year, you purchased Isuprel. And according to the Wall Street Journal, the price went—now, remember, it was $44 a vial in 2013. The price went to $1,346 per vial. This is an increase of more than 500 percent after you purchased the drug. And the only thing that has changed is the label.

So I am trying to figure out how we reconcile this is a drug that I guarantee you I would be shocked if the majority of the people taking that drug are not on Medicare—how we reconcile fixing the Tax Code so that it is fairer because I do not want to demonize you for using business practices that we allow you to use in our country, but there is something way out of whack here. What accounts for a 500-percent increase in a vial of a drug where the R&D has already been done and the price had already been raised from fivefold immediately before your acquisition of the drug? How can you do that? Because there is no competition for the drug?

Mr. SCHILLER. Well, first and foremost is ensuring that our patients have the drugs they need and they are safe and they are efficacious. This drug that you are talking about is a hospital-based drug. It is part of a protocol. Any patient that needs it is getting it.

The analysis on pricing for a drug, as you can imagine, is quite complex. There was work being done by the prior owner before we bought it, looking at the benefits of this drug to the system, to patients, to hospitals, and the conclusion was that it was significantly underpriced. When we closed on the transaction, we continued that work and took the pricing actions that you acknowledged.

I would add, though, however, this is one out of thousands of products that we have. The vast majority of our revenue in the United States is governed by contracts with managed care, et cetera, where their price increases are stipulated in contracts and, we do not have free pricing—free ability to raise prices like that. These are anomalies. And, a lot of it is driven—but just that, the vast majority of the drugs, price increases are not anywhere close to that.

Senator MCCASKILL. I would love to pull back the curtain and figure out how you price that. I would love to figure out how you

did that. I would love to understand how it goes from 215 per—you did not change the drug. The drug is the same, right?

Mr. SCHILLER. It is.

Senator MCCASKILL. The protocol is the same, right?

Mr. SCHILLER. It is.

Senator MCCASKILL. I mean, I would love to figure out the formula. I mean, why not $2,500 per vial? Why not $3,000 per vial? I mean, how in the world did you figure out that it was underpriced? Because there is not a generic competitor, which I do not get. I bet there will be soon if you are getting $1,300 a vial for it.

It is a mystery to me how that number came about. And maybe you want to submit how that came about, because I will be shocked if the American taxpayers are not paying the majority of that, because if it is hospital-based, and they are over 65, it is all Medicare, because it is not something anybody is getting—it is not Part D, right?

Mr. SCHILLER. No, it would be part of the protocol, so it is a fixed price for a procedure. So the procedure would not cost anything more because the price of a drug went up.

Senator MCCASKILL. It is not the subject matter of this hearing, but I got distracted when I saw that. I apologize to the Chairman that it is not the subject, but it should be. We should do one on this, how we figure out these drugs going from—and it is happening all over the place in the pharmaceutical industry where drugs are just magically—we are having these mergers, and then all of a sudden drugs are going from 50 bucks to 250 bucks, or they are going from 500 bucks to 2,000 bucks after a merger and acquisition. And I cannot figure out why. And it is really problematic. Hopefully on the next round I can get to something that is more topic-based, but I could not resist.

Thank you, Mr. Chairman.

Senator PORTMAN. Thank you, Senator McCaskill.

I have some questions with regard to the portrayal you gave us in terms of the tax advantages of both your initial decision to merge, and just as background you talked about this Valeant U.S.-headquartered company had a reported tax rate around 35 percent, teams up with a Canadian pharma firm called Biovail, kind of a merger of equals, would you say? Biovail had its headquarters in Canada, obviously, a territorial system there we talked about which gives them certain advantages; but, second, they had a statutory rate of about 27 percent. How has that merger and being a Canadian company affected your ability to do acquisitions?

Mr. SCHILLER. Sure. So at the time, as I mentioned in my opening statement, we were equal in size and small in the context of the global pharmaceutical industry, in similar therapeutic areas, similar geographies, focused in the United States and Canada, and both struggling to get scale. The companies came together. The decision to be in Canada did not drive the discussion, did not drive the decision that the merger made sense. But when it came down to constructing the transaction, there was only one possibility if the transaction were to occur, and that was to be in Canada, because if we were to contemplate coming to the United States, there would have been such significant dyssynergies that it would make coming

up with a price that both sides would agree to and both sets of shareholders would agree to impossible.

Senator PORTMAN. Including the tax advantages in going to Canada, as we talked about earlier.

Mr. SCHILLER. Yes. Those dyssynergies I am talking about are tax dyssynergies.

Senator PORTMAN. OK. So you go there, and my question to you is acquisitions. In that short period of time, since 2010, you have made lots of acquisitions. In fact, you say you started a small company. Now you have made $36 billion worth of acquisitions, $30 billion in the United States, just in that short period of time. So I think one of the words you used in the testimony was it kind of "turbocharged" your ability to do acquisitions. And that is part of, what we are looking at here, not just U.S. companies leaving our shores because of the tax disadvantages in the United States, but also once they leave, then looking back into the United States and acquiring additional companies. And you have been very successful doing that.

One of the companies that you acquired was Bausch & Lomb. We will talk about that. Another is Medicis. Another is Salix. And in each of those, you showed us kind of what you were looking for, which makes sense. A company is not going to purchase another company just to make things break even. You want to make a nice return. And you were talking about a significant return. You were looking for 20-percent rate of return over a 6-year—and a 6-year payback period. That is the deal, basically will pay for itself in 6 years. And in these three cases, it looks like you got to that, or very close to that because of the synergies, as you say, on the tax side in large measure—not that these did not make sense for other reasons. So when I look at these decisions that you have made, I see them as being tax motivated, and they have worked for you.

Salix, by the way, we will talk about first, if you do not mind. Here is a U.S. company. They were thinking about inverting. The Federal Government, the Obama Administration comes up with the regulations against inversions, particularly the percentage of shareholders that have to be foreign. They say, well, that is going to stop us from inverting, so let us just become a target of a foreign takeover. So here is a company that was blocked by Federal regulations from doing what they were going to do, invert; instead, they say, "Let us just be taken over by a foreign company." And, indeed, 11 of the 12 companies that bid for them were foreign, and you all won that bid.

On Salix, if you look at page 80 of the appendix, I can see where you have laid out some different results based on what the tax rate might be. And, again, that makes sense from your point of view, specifically, this idea that, you wanted to be able to show over 6 years that you could get effectively the return to shareholders that would make the deal pay for itself at a 20-percent internal rate of return.

My question for you is: With regard to Salix, is this presentation made by the Valeant management to the Valeant board one that you think was instructive to the board to make the decision to move forward with the deal? In other words, were these tax alternatives that you laid what really led to the board's decision?

Mr. SCHILLER. Sure. So as I mentioned in my opening statement, there is no question being a Canadian company subject to their territorial tax regime has created significant benefits for the company and its shareholders. I would, however, describe the benefits and how we capture those benefits slightly differently than as was laid out.

As I mentioned in my opening statement, when we look at a target, we are looking at whether it is a strategic fit, first and foremost. Second, we are looking at whether or not the returns are sufficient for our shareholders. It is their money; deploying capital is probably the most important responsibility a senior management team has.

We look at statutory tax rates when we are looking at deploying capital. We look at lots of other factors and run lots of scenarios, including what we think the tax rate would be, a scenario with the tax rate in our hands. That is not a benefit we give to a seller. That is a benefit that we retain for our shareholders.

So in the Salix case, the materials you pointed out, the debate in the board room was whether a 15-, 16-percent return was sufficient to go forward or whether we should wait for higher return opportunity that meet our thresholds, and the decision was that it was a great company, it was sufficient, and we put a lot of capital to work very quickly, and rather than waiting for other things to come along, uncertainty in terms of timing, size, quality, et cetera.

The benefit that we clearly get is, in our hands, a dollar of revenue, we will bring more of that dollar of revenue to the bottom line than somebody that has a much higher tax rate, which gives us the ability to reinvest in our business, expand plants and R&D, or make other acquisitions and grow faster, create more value, become a more attractive employer, lots of other benefits.

Senator PORTMAN. Well, let me just, with regard to this question—and I will then turn back to Senator McCaskill. You showed the board how this acquisition would play out at three tax rates, as I see it here. One is a 36-percent rate, which was very close to Salix's projected effective tax rate of 32. And then the two lower rates you thought were possible after the acquisition, 5 percent and 10 percent. That is what is laid out in your materials.

Looking at this page, the only scenario that shows Valeant hitting or exceeding this targeted 20-percent internal rate of return was the company's lower-rate scenarios. So, again, assuming a share price of 160 bucks, Valeant projected that its internal rate of return on Salix would be 15.6 percent at the U.S. rate, but would jump up to 21 and 22 percent at the lower tax rates. Isn't that right?

Mr. SCHILLER. The numbers you called out are correct, but the debate at the board was whether the 15, 16 percent was sufficient.

The other scenarios are clearly meant to demonstrate the value to our shareholders, what they will ultimately get if we are able to achieve those tax rates. But in terms of evaluating whether to go forward with Salix, the debate in the board room was whether accepting something lower than our targets was sufficient, was a good enough risk-reward for our shareholders at that time. But, again, the significant benefit is there in our hands, and our shareholders will get that benefit.

Senator PORTMAN. Well, given that Valeant projects that it would only reach your target, which is the 20-percent rate of return, by dramatically cutting Salix's tax bill, I think it is fair to say the tax savings were an important driver of the deal, particularly because you told us that, you all are disciplined about it—which makes sense from a business point of view that you are disciplined about your financial guidelines and "across the board, the majority of our transactions are delivered above that targeted 20-percent rate of return."

Again, this is not about criticizing a company for looking at what the rate of return is and considering tax rates as part of that projection. But it is very clear to me in looking at the material you provided us—and this will come as no surprise to anybody who has looked at the U.S. tax system—that this is a significant reason that you all have proceeded not just with this transaction but with other transactions, including the other two we have looked at in some depth, because there you were able to make your 20-percent return on acquisitions, and without the tax advantage, you would not have been able to.

So, again, I appreciate your providing the information to us. I do think this is an opportunity for us to dig a little deeper in these examples, as we have in our report, to be able to understand what the real consequences are of the United States refusing to change its Tax Code and what it means in terms of not just losing U.S. company headquarters, but also losing jobs and investment.

I am going to have to go to another Committee to mark up one of my bills, and I am going to ask Senator McCaskill if she would please take the chair, and, again, gentlemen, both of you, thank you very much for coming and for your willingness to provide us important information that will help us in our objective here, which is to come up with a Tax Code that makes sense for our country and for our workers. Thank you.

Senator MCCASKILL [Presiding.] Thank you, Mr. Chairman.

I just have a couple more questions, and we will let you go. For both of you, Mr. Galvin—did you all hear the previous panel's testimony? So Mr. Galvin from Emerson talked about a 25-percent tax rate making us competitive because of other factors and he said if we went down to 10 or 12 percent, then you would have a race to the bottom by other countries that perhaps do not have the same leverage as we have and that the key is to make us competitive.

Do you agree with his statement that a 25-percent rate would make us competitive?

Mr. SCHILLER. Honestly, we have never spent a lot of time analyzing what rate in the United States would even the playing field. It is a tough analysis because security, rule of law, quality of workforce, infrastructure, there are so many other factors that go into play. And taxes is one cost item out of a very complex analysis.

Being competitive with—and you also have to take into account all the other rules around rates. Harmonizing rules and harmonizing rates would clearly take tax out of the equation. So I think it is a bit more complex than just is 25 percent the right number.

Senator MCCASKILL. Yes?

Mr. KOBZA. As I mentioned in my opening remarks and in response to Senator Portman's question, our decision to domicile the

combined company in Canada was driven by a number of factors which were outside of tax considerations. So it is not a question that we considered in great detail, and I am not an expert in United States or global tax, so I would have difficulty to respond to what exact rate would make the U.S. competitive.

Senator MCCASKILL. Would it be helpful for both of your companies—both of your companies are examples of companies that make—you still make the majority of your money in America, don't you?

Mr. KOBZA. In fact, for the combined company with Restaurant Brands International, only about 25 percent of our combined earnings are in the United States.

Senator MCCASKILL. OK. So you do not, but you do, Mr. Schiller, and I think there is a boatload of companies out there that still do, even though they may be parking money offshore because of tax reasons or being acquired by foreign investors for tax reasons or inverting for tax reasons. I think it would be important for us to get input about this. I think we need to know as much as possible, because tackling the Tax Code is hard around here, and it is not something we are going to go back and do again the next year. If we get this done, it will be in place for a while. So I think the more input we get, the better.

And the other question I had for you, Mr. Schiller, that I did not get to on my first round was: What were the benefits to your company of shipping manufacturing activity to Canada? I know that you did most of the contract manufacturing for both Medicis and Salix out of Canada. What were the advantages of manufacturing moving there?

Mr. SCHILLER. Well, up until Bausch & Lomb, we had no manufacturing facilities in the United States. Bausch & Lomb had some; Salix had none. So Valeant and Salix were using contract manufacturers.

We did have two plants, two large—we had three plants, but two large facilities in Canada—one in Steinbach, Manitoba, and one in Laval. And when we bought it, it was really looking at the cost of manufacturing through the contract manufacturing operations (CMOs), through the contract manufacturers, as to what we could do internally. And the plant in Laval was a dermatology plant, so it had all the capabilities of making the Medicis products—we have not done anything with Salix. We just closed Salix April 1, and I do not suspect we are going to be moving any Salix products anytime soon. So a few of the Medicis products we did, and some of the legacy Valeant products we have moved from CMOs as well, but it is based on the cost of manufacturing in our own plant versus what the contract manufacturers charge.

The Bausch & Lomb plants continue to run well, and we are looking to add capacity there because they are very good. The Clearwater and Tampa, Florida, plants and the Greenville, South Carolina, plants are very efficient plants, and we are looking to add capacity there when we can.

Senator MCCASKILL. Well, to whatever extent you can share with the Committee the analysis of contract manufacturing in Canada versus the United States and what the differentials are——

Mr. SCHILLER. In Canada, it is not a contract manufacturer. It is our own plants.

Senator MCCASKILL. You do not have any contract manufacturing in Canada?

Mr. SCHILLER. I do not think we use contract manufacturers in Canada.

Senator MCCASKILL. Well, what would be helpful to us is to see what the differentials are on contract manufacturing in the United States and other places. If you analyze contract manufacturing, I am assuming you looked at analysis that would include contract manufacturing in the United States, and it would be helpful for us to understand what factors weighed in there against contract manufacturing.

Mr. SCHILLER. Each product is unique, but in general, contract manufacturers have 15-to 20-percent margins, and the question is whether or not—so that is the margin they are earning for providing a service.

Senator MCCASKILL. Right.

Mr. SCHILLER. So that we would certainly save. Then the question is whether we can manufacture—the raw material costs are not going to be very different. It is a question of whether our operating costs are lower, higher, or the same, and it is really a product-by-product analysis.

Senator MCCASKILL. I guess one of the reasons I am interested is that if there was an analysis that went on on the cost of contract manufacturing, if there was an analysis of contract manufacturing in the United States, that is going to have an add-on—right? But so is contract manufacturing in Canada. If that analysis was done, it would be very helpful for us to see it, because we have a lot of people complaining that, the reason that Canada is more attractive is that labor costs are lower, but they have a single-payer system up there. And so I am trying to figure out how that all works, and as we analyze the Tax Code, including what is deductible and what is not, it would be important for us to have the benefit of any analysis your company has done. We need to see what you see so we can understand how we can be more competitive.

I think that the record will remain open for 15 days and will close on August 14 for this hearing. There may be other questions that we might have for you and for the other witnesses. We have a hard job, and it is exacerbated by the fact that we all do not see things the same way around here. So we are going to try to do our best to make the United States as competitive as it should be with all the other countries in the world in terms of job growth and economic strength. In the process, I just want to make sure that we do not diminish the natural strengths that still make our country a beacon to the world for R&D and innovation. I am sorry to say I am going to try to talk the Chairman into trying to figure out how we can look at—it is astounding—the merger and acquisitions that are going on in pharmaceuticals. What did my briefing say, what percentage of the income came from M&A over the last year, like 45 or—yes, I mean, a huge percentage over the last 3 or 4 years has just been through M&A. And in that process, how these drugs are being priced I think is a fascinating thing for us to understand, because that is what drives our debt right now, is health

care costs. That is the big problem we have in terms of our competitiveness in the future, is how do we get a handle on our entitlement debt, which is driven by and large by health care costs in Medicare. Sorry, but your company—I am sure you are not outside the realm of what is going on with other companies. I do not mean to pick on your company. But that drug is a great example of, I think, questions we need to ask about how this is happening and why.

Thank you both for being here, and I thank the first panel, and we will try to work together to see if we can level this playing field.

[Whereupon, at 11:59 a.m., the Subcommittee was adjourned.]

APPENDIX

Testimony of Jim Koch
Founder of the Boston Beer Company
To the Permanent Subcommittee on Investigations (PSI)
July 30, 2015

Chairman Portman, Ranking Member McCaskill and Members of the Subcommittee:

It is my honor to be here today as your Subcommittee investigates how the current corporate tax structure in the United States should be reformed to lessen the obstacles that exist to start, grow and maintain an American business.

The Boston Beer Company has humble beginnings. Using my great-great grandfather's recipe I started brewing in my kitchen in 1984. From there, I went from bar to bar trying to sell the new concept of a rich, flavorful, American beer. Named after the American revolutionary and founding father, Sam Adams, Boston Lager was born in April of 1985. Six weeks later, it won "Best Beer in America" at the Great American Beer Festival.

Our family of beers today includes 60 different and constantly changing beer styles. We are now available in all 50 states and more than 30 foreign countries. Today we're a team comprised of 1300 people with breweries in Boston, Cincinnati, and Pennsylvania. We have invested over three hundred million dollars in our breweries over the last three years, and we are proud that today, the craft beer industry, which once made up a few dozen companies, has grown to more than 3,600 local businesses around the nation. Despite that growth, today almost 90% of the beer made in the US is made by foreign owned companies. And foreign owned breweries have begun acquiring American craft brewers with nine of the most successful ones having been acquired in recent years. So I am concerned because growing, and expanding an American owned brewery is increasingly difficult because of how our corporate tax structure currently places American owned companies at a competitive disadvantage compared with their foreign competitors.

It is not uncommon for me to receive visits from investment bankers interested in facilitating the sale or merger of Boston Beer Company to foreign ownership. One of the principal financial benefits of such transaction is the ability to reduce the tax rate we currently pay. We are vulnerable because we currently report all of our income in the United States and pay a tax rate of about 38% on that income. Under foreign ownership, that rate, I am told, would be reduced to the range of 25-30% through various practices like expatriation of intellectual property, earnings stripping and strategic use of debt, offshoring of services, and transfer pricing. That means that a dollar of pre-tax earnings is worth about sixty two cents under American ownership but about seventy two cents under foreign ownership. To put it another way, Boston Beer Company is worth 16% more to a foreign owner simply because of the current US corporate tax structure.

So the question is, why haven't we sold Boston Beer to some multinational brewer or another foreign entity? The simple answer, it's just not who we are. Like Samuel Adams, our Patriot

namesake, we were born in America, have grown because of the advantages available in the United States and don't mind paying our taxes here in the United States in gratitude for the opportunities available in this great country.

But please don't mistake our core values for good financial decision making. I have to explain to shareholders why we have not taken advantage of some of strategies available to reduce the corporate tax burden-including by moving overseas. In response to economic pressures, other companies are or saving millions or even hundreds of million of dollars through complex tax planning every year. Rest assured Senators, while we are sitting here talking about corporate tax reform and what is needed to bring it about, there are folks in offices and boardrooms all over the world making their own kind of tax reform happen every day. The difference is that not one of them is accountable to constituents. Congress's inaction on this subject has created a system of do it yourself corporate tax reform available to few and understood by even fewer. Because of our broken corporate tax system, I can honestly say that I will likely be the last American owner of the Boston Beer Company.

Due to hard work, innovation, and diligence, American craft brewers have created thousands of well-paying skilled manufacturing jobs and brought respect around the world for American beer. In fact, there is no other manufacturing sector I know of in the United States that has grown for thirty years and has achieved double digit growth for 16 quarters straight. But, when these foreign acquisitions occur, American jobs are often cut or shipped overseas, less investment is made here in the US and other cost cutting measures on management and sales force are implemented along with reductions in local philanthropy and community involvement.

There are solutions: Cut the highest-in-the-world U.S. corporate tax rate to the mid-20s. And bring America's international tax system in line with the rest of the industrialized world, by allowing U.S. companies to bring their overseas earnings home without additional taxes—just like the British and Canadians (among others) allow their businesses to do. Senator Portman's recent proposal with Senator Schumer provides a strong, bipartisan road map on the international piece of tax reform. With these reforms, I believe we can unleash a lot more job creation and innovation in this country. Without them, I fear America will continue to fall behind economically.

Thank you again for having me here today and for listening to some of my thoughts on this subject. I am pleased to answer any questions the panel may have.

Statement by David E.I. Pyott

Permanent Subcommittee on Investigations

July 30, 2015

Thank you, Chairman Portman and Ranking Member McCaskill.

My name is David Pyott, and I am the former Chairman & CEO of Allergan. Until it was acquired by Actavis in March 2015, Allergan was a great American pharmaceutical company—entrepreneurial, science-driven, and customer focused. It boasted many market-leading innovative products, including eyecare medications, medical aesthetics, and Botox (which had therapeutic purposes as well as its famous cosmetic indications). In our product markets, we were typically number 1 or number 2 globally.

Allergan had only three CEOs in its 65-year history, and I was privileged to have that job for 17 years, from 1998 until 2015. During that time, Allergan experienced tremendous growth, going from $600 million in sales in 1997 to more than $7 billion in 2014. Sales growth led to valuation growth: When I first joined Allergan, its market capitalization was $2 billion; by early 2014, it was $37 billion. We also added more than 6,000 employees to our workforce over that period—from 4,000 in 1997 to 10,500 at end of 2013. More than 60% of our sales were domestic, but Allergan had considerable amount of international sales revenue, through various foreign operating subsidiaries.

Our growth was principally organic; acquisitions contributed only about $450 million of our sales revenue. We grew through extensive investment in research and development, leading to new products. Allergan's R&D investments increased from less than $100 million to over $1 billion in 2014, leading to a steady stream of regulatory approvals from the FDA and foreign regulatory agencies.

In 2014, Allergan's future outlook was bright: We projected double-digit revenue growth and mid-teens increases in earnings per share for the period from 2014–2018, even after continued double digit increases in R&D investment.

But ultimately, those very qualities—sustained growth, robust research and development, a long-term focus, and international sales—made Allergan a very attractive target for acquisition. And in the end, that almost inevitably meant acquisition by a foreign company.

The reality is that the U.S. Tax Code, with its high corporate rate and outlier worldwide system of taxation, puts American companies like Allergan at a tremendous disadvantage. Just before our acquisition, Allergan's effective tax rate was approximately 26%—a rate that would have been even higher if we had repatriated more non-U.S. earnings. Before the acquisition, we had almost $4 billion in cash, most of which was located offshore and, under U.S. tax law, could not be repatriated without a tax

penalty. That stands in contrast with our competitors based in other industrialized nations, most of which permit their companies to repatriate overseas earnings without incurring additional tax.

These tax advantages are worth literally billions—billions that a foreign acquirer has access to—essentially for free—but American companies do not. Unsurprisingly they use those billions to buy up American companies that cannot compete with the tax savings offered by the vast majority of other OECD nations. But once the American company is bought, its new foreign owner has every incentive to strip out its intellectual property and take those patents abroad, and leave its new American subsidiary loaded up with debt. The result is a loss to the Treasury, to jobs and wages, and to the incentive to build innovative, long-term-focused companies in the United States in the first place.

The 2014-2015 battle for control of Allergan

Over the course of 8 months in 2014, a battle raged for corporate control of Allergan. We were targeted for takeover by Valeant—a Canadian firm that has had an enormous appetite for acquiring pharmaceutical companies, and has stated no interest in growing through innovation and R&D of its own. But Valeant had just completed an $8 billion acquisition of Bausch & Lomb in 2013, and was too weak and laden with debt from that transaction to contemplate buying Allergan on its own. So Valeant entered into a partnership with Pershing Square, a firm run by activist investor Bill Ackman, to go after Allergan together. It was the first-ever partnership of its type. In the February to April 2014 timeframe, using stock purchases and then options and derivatives, Pershing Square was able to accumulate about 9.7% of Allergan's outstanding shares without making any public announcement of its actions.

On April 22, Valeant submitted a bid to buy Allergan for $47 billion, an increase from the $37 billion valuation when Pershing Square initiated its first purchases of stock, a premium of $12 billion, or 25%.[1] Such a premium was enabled by the enormous tax savings available to Valeant as a foreign company, allied with their rapacious cost cutting plan. Valeant, as a Canada-based enterprise with operations in Bermuda, Ireland, and Luxembourg, had an effective tax rate of about 3%. And when it made its case for buying Allergan to Wall Street and our investors, Valeant claimed it could reduce Allergan's 26% effective tax rate to 9%—a difference of 17% or $500 million. Applying a price earnings multiple to approximately $500 million in tax savings, this gave Valeant and Pershing Square roughly a $9 billion valuation advantage. In simple terms, Allergan was worth $9 billion more - just by being moved to foreign control than it was worth as an American company.

Nevertheless, I and the Allergan Board did not think the Valeant transaction was in the best interest of Allergan's shareholders. Even though it could offer a substantial premium, owing to its tax savings, Valeant's long-term plans for Allergan did not seem to the Board and I designed to maximize the value of the company over the long term. Valeant and Pershing Square made clear they intended to strip Allergan's operations.

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[1] Curiously, the next day, Pershing Square posted a billion dollars in paper profit – something I hope will lead the Securities & Exchange Commission to investigate the novel structure of their transaction to determine whether Valeant and Pershing Square violated insider trading laws and other securities regulations.

Valeant's acquisition proposal was to slash Allergan's investments in R&D from more than $1 billion to about $200 million—along with our market-building investments in Allergan's salesforce and promotion and educational programs for physicians. Consequently draconian reductions were planned not only for our R&D department but also for our selling, marketing and administrative staffs. Overall, Valeant's final plan, filed on the very day of the announcement of the acquisition, proposed a reduction in operating expenses of over 40%.

In my view, Valeant's strategy was a clear example of "asset stripping" for short-term profit. That strategy is not sustainable in the long-term; more companies must be continuously acquired in a roll-up before the project collapses. Under the terms of the initial bid for Allergan, Valeant planned to load up Allergan up with more than $22 billion in new debt; taking the debt load of the combined company, Allergan and Valeant, to more than $50 billion.

As the proposed acquisition undervalued the company and gutted our operations, we vigorously resisted the hostile bid as we ramped up our performance and evaluated many strategic alternatives. The battle for control lasted 8 months, and although the Board was put under enormous pressure in the media and by event driven investors, the Board never buckled. We were convinced that this was not a value-creating deal. Beyond just selling to the highest bidder, a major consideration for the Allergan Board was any potential acquirer's commitment to ongoing investments in R&D as well as in sales and marketing infrastructure both in the US and around the world. Ultimately, the Board decided to seek out a "white knight" with the intent to create higher value for our shareholders than the Valeant offer which was raised three times and signaled that a fourth raise was in prospect.

But in our evaluation of potential white knight bidders, it was clear to me that only a foreign-domiciled company could be in a position to outbid Valeant whilst still creating value for their own stockholders. American firms could not match Valeant's favorable tax position. The tax-planning techniques available to foreign acquirers are too lucrative: (1) a debt push down on the US entities by tax-advantaged foreign entities that are domiciled abroad in low tax jurisdictions, and (2) migration of intellectual property to low-tax jurisdictions, even despite a penalty paid to the IRS shortly after the acquisition. Valeant contemplated both.

Ultimately, we announced in November 2014 a bid for Allergan by an Irish pharmaceutical company called Actavis for $66 billion. Similar to Valeant, Actavis could immediately reduce Allergan's effective tax rate—from 26% to 15%. As the figures below illustrate, both Valeant and Actavis were able to offer substantial acquisition premiums above Allergan's $37 billion valuation in February 2014.

Figure 1 — Approximate Allergan Valuation Over Time	
First stock purchases by Pershing Square — February 2014	$37 billion
First Valeant Bid — April 2014	$47 billion
Highest formal bid by Valeant — October 2014	$55 billion
Actavis bid — November 2014	$66 billion

Actavis offer at close — March 2015	$71 billion[2]

But for the systematic disadvantages of the U.S. tax code, however, Allergan would likely not have been sold. The return created by the billions of dollars available to shareholders just for selling to a foreign firm, however, can be irresistible. I liken it to playing on a sports field physically titled 20 degrees against the home team.

Implications of the Allergan takeover

I am proud that we were able to salvage most - and what we could of - a great American company. I am especially pleased to report, for example, that in 2014—in the midst of a battle for our existence—Allergan had the best operating year in its 65 year history: Sales in local currency increased by 16% from $6 billion in 2013 to over $7 billion in 2014.

Actavis is committed to maintaining the best of Allergan in the new combined company, and it is a point of pride for me that Actavis adopted Allergan as its new corporate name in June 2015. The new combined company will dedicate $1.8 billion to R&D, a substantial increase from the $1 billion expended by legacy Allergan.

But it is not all good news. Actavis was up front and clear with employees and other stakeholders that both sales synergies, and more importantly cost synergies, have to be found to pay for the acquisition premium to acquire Allergan. Those synergies must total about $1.8 billion, and will entail a reduction of about 11% of operating expenses from across both firms. As for jobs, although I am no longer with the company, I would estimate that about 1,500 jobs will be eliminated from the legacy Allergan side, most of them in California.

Conclusion

Reflecting back on the fight for control of Allergan, I am convinced that we would have remained an independent, American company had it not been for the disadvantages caused by our uncompetitive U.S. corporate tax system. The implications for the rest of the pharmaceutical and biotech industry are clear. Unless Congress acts, the price of inaction will be the continued loss of the most innovative companies in our economy. My view is that this will extend to other firms across the entire healthcare industry as well as other industries.

The primary problem is the simple one: We have the highest corporate tax rate in the world, and we need to reduce it to be in line with other leading industrial economies. We must also transition to a modern territorial tax system that allows U.S. businesses to expand abroad while creating jobs at home.

The penalty on American companies for the repatriation of foreign earnings causes economic problems. The location of cash should not distort the decision of where to invest it. As it now stands, the "lock

[2] Due to the rise in Actavis stock price post announcement. About 60% of payment was in Actavis stock, 40% in cash.

out" of foreign earnings incents U.S. businesses to create jobs abroad, by reinvesting un-repatriated earnings, rather than bringing those earnings home to invest domestically.

I applaud the Subcommittee for focusing on these important issues, and thank you for the opportunity to testify about my experience.

Testimony of Mr. Walter J. Galvin
Before the Senate Permanent Subcommittee on Investigations
U.S. Senate

Hearing on the
"Impact of the U.S. Tax Code on the Market for Corporate Control and Jobs"
July 30, 2015

[AS READ]

Good morning Chairman Portman, Ranking Member McCaskill, and Members of the Committee.

My name is Walter Galvin; I am the former Vice Chairman and Chief Financial Officer of Emerson, a 25 billion dollar global manufacturing company founded in the United States 125 years ago. Emerson has over 110 thousand employees and operations in more than 150 countries.

Emerson is a large U.S. taxpayer. In each of the last three years, we paid $1.3 billion in taxes worldwide. Of that, over half was paid in the U.S. at an effective tax rate of approximately 35 percent. This high effective rate is why Emerson is so engaged in the tax reform debate.

Emerson's business is global. Over 55 percent of our sales are outside the U.S., **and several of our major competitors are domiciled abroad**. Being domiciled in the U.S. means we pay more in taxes on our worldwide earnings. It means we are prone to being outbid by our foreign competitors for acquisition targets. And, perversely, it also means that Emerson is encouraged to invest abroad, rather than bringing cash home and paying taxes to the U.S. Treasury.

All these are results of our antiquated tax code failing to evolve, while other countries have modernized their tax laws to gain an advantage for their homegrown companies.

Mr. Chairman, Madame Ranking Member and Members of the Committee, **Congress must modernize our tax code by moving to a territorial system and lowering the corporate rate like other countries have done, and continue to do.**

Explaining this conclusion, my testimony will focus on three areas:

First, why America's tax cost on foreign profits is such a disadvantage for U.S. businesses.

Second, how other nations have set examples we can follow; and

Third, how Emerson can serve as an example of an American-based multinational that lost out to foreign competitors because of our tax code.

To begin, **the combination of our high corporate tax rate and the way the U.S. taxes foreign profits can make U.S. companies more valuable in foreign hands** – which is leading to American businesses being stripped away.

A recent analysis by Ernst & Young found that, from 2004 through 2013, foreign buyers acquired $179 billion more of U.S. companies than we acquired of theirs. Additionally, data provider Dealogic reports that the gross value of foreign takeovers of U.S. companies doubled last year to $275 billion and, at the current rate, will surpass $400 billion this year. These takeovers reflect thousands of U.S. companies leaving American shores.

How can we stop this accelerating exodus? Congress must remove the premium **only American companies' pay** by moving to a territorial system and reducing the top corporate tax rate.

We know it can be done. Other nations, like the U.K., are successfully reducing their top rates. In 2009, the U.K. switched to a territorial system while their corporate rate stood at 28 percent. Now, that rate is 20 percent, and earlier this month, the U.K. released a plan to drop that rate further to 18 percent.

Companies are taking note. Monsanto, an American company also founded in St. Louis more than 100 years ago, is attempting to merge with a competitor, Syngenta, and set up a new parent company in the U.K. It is no mystery why.

According to the U.K.'s Chancellor of the Exchequer, George Osborne, their lower rate sends out a loud and clear message around the world that the U.K. is quote, "open for business."

I have two very real examples of how Emerson's investors, shareholders, and employees have been directly impacted by America's out of date tax code. As background, Emerson uses strategic acquisitions to augment existing businesses, acquire technologies and engineering capabilities, and penetrate faster-growing markets, while enhancing our position in the markets we serve.

In 2006, Emerson sought to acquire a company called American Power Conversion, a Rhode Island-based producer of high-tech electronic equipment. At that time, over half of APC's earnings were made outside the U.S. Emerson competed against Schneider Electric, a French company, **and Ohio-based Eaton Corporation**, to buy APC.

Emerson valued the company at just under $5 billion, but Schneider ultimately acquired the company by offering about $5.5 billion. **The principal reason Schneider's valuation of APC was higher was due to the French tax law on repatriation.**

Headquartered in France, 95 percent of Schneider's repatriated profits are exempt from French taxes, **so APC's profits are worth more to Schneider because they can be repatriated at a tax rate of about 2 percent. By contrast, if Emerson repatriated those earnings, we would be subject to a tax rate of approximately 17 percent.** That 17 percent is the difference between our 35 percent corporate rate, and foreign taxes we pay elsewhere. The difference between Schneider's rate of 2 percent and Emerson's rate of 17 percent made APC worth $800

million more to Schneider. Therefore, Schneider was able to outbid Emerson and what had once been an American company, became a French domiciled company.

As for Eaton, they dropped out of the bidding process fairly early, and about six years later, acquired Ireland-based Cooper Industries. Eaton is now an Irish domiciled company, enjoying a lower worldwide tax rate.

Second, America's worldwide system creates a perverse incentive to keep foreign profits abroad. A few years ago, Emerson bought a company in the U.K. called Chloride for about $1.5 billion with cash we had earned abroad, and kept abroad. We considered other options for that cash, but the U.S. would have charged us an extra 10 to 15 cents in taxes on every dollar to bring those earnings home. So where will we get a higher expected return – from one dollar invested in the U.K., or only 85 cents in the United States?

I fully appreciate the magnitude of effort required to reform America's tax code. But if the United States is serious about slowing the unprecedented outflow of capital and jobs to foreign countries, we must permanently restore the competitiveness of U.S.-based multinationals. We need to do this sooner rather than later. Every time a company is acquired and their headquarters is moved overseas, there is a real community impact. In addition to costing American jobs, this impacts local communities because of a decline in state and local tax revenue and a loss of corporate philanthropy.

Fortunately, thoughtful efforts—like the bipartisan Portman-Schumer international reform framework—are moving the conversation forward, and give me hope that Congress will do what is necessary to stem this outflow.

In closing, we cannot expect to create more jobs at home if we continue punishing businesses like Emerson who want to remain headquartered here. America's businesses and workers are the best in the world, and **we're not asking for a tax handout – we're asking for a level playing field. With that, we can compete anywhere in the world, and win.**

Thank you, and I welcome your questions.

WRITTEN STATEMENT OF
HOWARD B. SCHILLER
ON BEHALF OF
VALEANT PHARMACEUTICALS INTERNATIONAL, INC.

BEFORE THE
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

JULY 30, 2015

Chairman Portman, Ranking Member McCaskill, and Members of the Subcommittee, I would like to thank you for the opportunity to appear before you on behalf of Valeant Pharmaceuticals International, Inc. for this hearing regarding the impact of the U.S. tax code on the market for corporate control and jobs. This is clearly an important issue, and I hope that my testimony here today proves helpful in your efforts to understand and address this issue.

I would like to begin with some background information regarding our company to explain who we are, what we do, the principles that guide our operations generally and our approach to corporate acquisitions specifically. Our company and our strategy are often misunderstood, and we appreciate the opportunity to explain a little about how we approach our business and how we have grown so successfully in a relatively short period of time.

Overview of Valeant's Business

Valeant is a global specialty pharmaceuticals and medical devices company. Valeant's operations are highly diversified on both a geographic and therapeutic basis. On a geographic basis we operate in the United States, Canada, Europe, the Middle East, Latin America, Russia, Africa and Asia Pacific. We have a diverse mix of customers throughout these markets, and we are proud to serve patients and customers in both developed and emerging economies. We also have a diversified product portfolio, with a focus on eye health, dermatology, neurology, gastrointestinal health, branded generics and over-the-counter products. We believe that the diversity of our customer base and product mix is a key ingredient of our success and we continue to focus on opportunities to grow our business worldwide wherever we see valuable growth opportunities.

Headquartered in Laval, Quebec, Valeant has approximately 19,500 employees worldwide, approximately 5,700 of whom are based in the United States. In the past five years, as our company has grown rapidly, so has our workforce – growing from approximately 4,300 at the end of 2010 to our current size of approximately 19,500 employees. Our highly talented and committed workforce has been instrumental in our ability to achieve the growth we have experienced. We take great efforts to ensure that we have the most talented, committed, hard-working, and ethical workforce in the industry, and we are extremely proud of what they have accomplished. We recently completed a survey of our worldwide workforce and the results were remarkable – nearly 90 percent of our employees are happy with their positions and are confident that Valeant is on the right track for continued growth, and over 80 percent would recommend Valeant as an employer to their friends and colleagues. With more than three-quarters of our

employees participating in the survey, many of whom have joined us through recent acquisitions, the survey results are a testament to the effectiveness of our efforts to integrate acquired companies quickly into Valeant's forward-looking, high-growth culture.

With our extraordinary workforce and strong and growing mix of products, we have been able to achieve remarkable growth in a relatively short period. Over the past five years, our sales have grown from approximately $1.2 billion in 2010 to projected sales of approximately $11 billion in 2015. In that same period, we have grown from a company with a market capitalization of less than $8 billion, to a company with a market capitalization of over $80 billion. We are very proud of the growth we have achieved and the returns that we have been able to provide to our shareholders.

Our growth has been facilitated in large part by our investments in the United States, and we in turn continue to expand our U.S.-based operations, reinvest in our U.S. business, and create good, quality jobs here in the United States. In 2008, Valeant had fewer than 1,000 employees in the United States. Today we have over 5,700. For example, when we purchased Coria Laboratories in 2008 – one of the first acquisitions after our chairman, Mr. Pearson, joined a predecessor of our current company and began to implement the strategy that we still follow today – its dermatology business, including the CeraVe skin care line, had annualized net sales of approximately $40 million and employed a U.S.-based sales force of approximately 40 people. We have grown the CeraVe brand alone from approximately $5 million in annualized net sales at the time of acquisition to what we expect to be approximately $150 million in annualized net sales by the end of 2015, and we have over 300 U.S.-based employees supporting the Coria business.

Valeant has 12 manufacturing sites throughout the United States, with our largest facilities in Rochester, New York; Greenville, South Carolina; Saint Louis, Missouri; Tampa, Florida; and Clearwater, Florida. And we are in the process of expanding our U.S. manufacturing facilities – working with local officials, businesses, and stakeholders to expand our presence and increase our investment in the communities where we operate. For example, we currently employ over 800 full-time people in Rochester, where we focus on advanced manufacturing and R&D. In May of this year, our Rochester facility marked the validation of its first full-commercial high-speed line producing ULTRA contact lenses. The output of this manufacturing line is now four times greater than that of the site's original pilot line. The output from that manufacturing facility will serve not only the U.S. market but foreign markets as well – allowing us to export high-quality, American-made goods while growing our high-quality U.S. workforce in New York and elsewhere. And just two weeks ago we decided to further expand our manufacturing capacity in Rochester, and bring even more skilled jobs to that community. By the end of this year, we expect to have over 900 full-time employees in Rochester, where they will produce more than 200 million Bausch & Lomb ULTRA lenses annually, for sale within and outside of the United States. This is a very different path from what Bausch & Lomb was contemplating prior to Valeant purchasing it, when the intention of the previous management was to move manufacturing from Rochester to Ireland. Valeant remains committed to adding significantly to our manufacturing presence in Rochester. We are also looking to expand our manufacturing facilities in St. Louis, where we presently employ about 414 people who manufacture ophthalmology-related equipment and instruments. Similar to our evaluation

of our contact lens manufacturing footprint, we are currently reviewing the consolidation of our surgical manufacturing sites for greater efficiency with the potential to expand our manufacturing capacity in St. Louis in the future.

To be sure, we are a true multinational company. While the United States is our largest market, over the past seven years, we have invested around the world to grow our business. About a third of our most significant transactions since 2008 involved acquisitions outside the United States, as we have expanded our presence in Canada; Latin America; Central, Western, and Eastern Europe; the Middle East and North Africa; and the Asia Pacific region.

We operate in a highly regulated industry. First, our products cannot be marketed until we demonstrate to our regulators that the products are safe and effective for their intended purpose. Second, our manufacturing facilities must strictly comply with requirements designed to ensure that products are made and packaged safely. This applies whether we manufacture the products directly or through third-party contract manufacturers. Third, our sales forces are regulated to ensure that we market and promote our products only for the indications covered by the regulatory approvals. Historically Valeant has had a strong record of compliance with these and other regulatory requirements. Some of the companies we have acquired over the years were subject to corporate integrity agreements that resulted from regulatory failures, and we have worked diligently to resolve past problems and have endeavored to operate in compliance with applicable requirements.

Valeant's Values and Guiding Principles

The growth and success we have been able to achieve at Valeant is rooted – we believe – in the values and core principles that guide all of our business decisions. Our values and core principles provide the overall direction for our company, and provide us with the tools necessary to rise to any challenge by leveraging our collective hard work and effort along with our unwavering competitive spirit. They help us set goals based on our organization's potential and what we hope it will become. We have consistently adhered to these values and principles since Mike Pearson first joined Valeant in 2008, and we continue to believe that they are critical to our future growth.

- *Putting Patients and Customers First through the Highest Ethical Standards in the Industry*

Our first and most important commitment is to the health and safety of the patients and customers who use and rely on our products. To ensure their health and safety we are committed to operating according to the highest ethical standards. Through that commitment we have been able to maintain a record of quality and regulatory compliance of which we are very proud. Our employee surveys show that our employees share that commitment and share the view that Valeant as a company is committed to the highest ethical practices. Valeant has been committed to bringing those same standards of practice to the companies we acquire, and we are proud of our track record of consistently improving the quality and compliance track records of the businesses we acquire.

- *Commitment to Innovation through an Output Driven R&D Approach*

Valeant has a unique – and often misunderstood – approach to innovation and research and development. This approach has its roots in the changes Mr. Pearson made when he first joined Valeant in 2008. At that time, Valeant – like many pharmaceutical companies – was focused on very uncertain, early-stage R&D – spending large sums on R&D with the hope of finding a blockbuster product that could be sold worldwide. That strategy was not working – and Valeant was underperforming as a result.

We changed that approach in 2008, and Valeant began focusing on R&D that we believed could achieve results. We wanted to focus less on how much we spent on R&D and more on what we could get out of our R&D – less on inputs and more on outputs. We did not abandon R&D – but instead focused on those types of R&D where we believed we could achieve results both for our investors and our patients and customers.

We have stated a number of times that innovation is obviously critical to the healthcare industry, and it is also critical to Valeant. We source innovation through our internal research and development efforts, through acquisitions, and through in-licensing. And we are agnostic as to where we get innovation. We do run a focused R&D model, and we are careful about where we build our internal capabilities. We focus on critical skills like trial design, and we outsource commodity activities and leverage industry overcapacity where we can. While we target a certain total amount of R&D spending for each given year, we will spend more or less, as needed, depending on the promise of the programs and the productivity that we believe we can achieve.

This disciplined approach to R&D has borne fruits. As an illustration, in 2009, we acquired Dow Pharmaceuticals Sciences, a research and development company that specialized in creating and developing dermatology products and provided an important R&D platform based in Petaluma, California. We have continued to harness that R&D platform, and after six years we have been able to bring new, innovative products to market. For example, in the past year we launched Jublia – an innovative antifungal product – which after our most recent quarter is generating annualized sales of approximately $450 million, and Onexton – a dual action acne product – which after our most recent quarter is generating annualized sales of approximately $70 million. We also have technology platforms in the form of Victus, Stellaris, and our new ULTRA contact lens. And we look to complement this with outside collaborations.

The results, we believe, speak for themselves. We had 20 product launches in the United States alone last year, and we have a rich pipeline of products sourced from internal development, compounds such as Lumminess and Vesneo from acquisitions such as Bausch & Lomb, and in-licensing products like Croma and Emerade

We intend to maintain this approach to R&D – measuring our R&D not by how much money we spend, but by our ability to achieve results.

- *Decentralized Business Model*

Valeant operates its business units using a decentralized operational model in which individual business units are given control over and held accountable for results within their business unit. This approach empowers our employees to take initiative, be innovative, and take ownership over their work. It also ensures that decisions are made closer to our customers, which usually allows us to make better decisions. This model has allowed us to achieve significant growth in our business units – both those developed internally through organic growth and those we have obtained via acquisitions.

This decentralized business model also allows us to operate our business leanly – with limited "headquarters" staff consisting of the few functions such as finance and compliance that operate on a centralized basis to ensure proper controls. Rapidly integrating acquired businesses into our model is a key to our success and one of the drivers of our ability to realize synergies and value through corporate acquisitions.

- *Disciplined Approach to Business Development with a Focus on High Rates of Return and Rapid Payback Periods*

Finally, a disciplined approach to business development, with a focus on achieving high rates of return and rapid payback for our shareholders has been a key driver of our growth, which I will discuss in greater detail below.

In summary, over the past seven years, we have pursued a unique business strategy that has combined rapid growth with the highest standards of ethical business practice to achieve remarkable results for our customers, patients, employees and shareholders. This is not to say that we have not made mistakes or that every decision we have made has paid off. But overall, we have achieved a remarkably high success rate that has fueled our tremendous growth.

Valeant's Approach to Business Development

Along with organic growth, growth through acquisitions has been an important part of Valeant's business model, and we anticipate that business development will continue to be an important part of our story going forward. Since 2008, we have completed approximately 140 transactions, and we are continually looking for new opportunities to grow our business and deliver superior returns to our shareholders.

Our approach to business development is guided by several core principles.

First and foremost, we only pursue transactions that make strategic, business sense for Valeant. We thus generally look for companies with products in therapeutic segments that complement our existing product portfolio and are consistent with our goal of focusing on high-growth areas. When we see an opportunity to acquire a business that we think is underperforming, we will do so if it makes sense for our shareholders. Approximately three-quarters of our product portfolio tend to be products that are directly paid or reimbursed through private insurance, and are not heavily reliant on managed care or government reimbursement.

We have a preference for such products because it limits our exposure to changes in government regulations or third-party payers' reimbursement policies that could reduce reimbursement for our products, and thereby adversely impact our results. If a potential acquisition target meets those criteria, but is a company that has struggled financially, faced regulatory problems, or otherwise faced challenges, Valeant is not afraid to take a chance on success. If a potential acquisition target has promising products that for one reason or another have not realized their full potential, we believe we are often uniquely positioned to deploy our management and business strategy to realize that value and grow those businesses to provide superior returns to our shareholders.

Second, we take a financially disciplined approach to business development looking for opportunities where our decentralized and efficient business model can achieve returns that are far in excess of our own cost of capital. When evaluating acquisitions we assess a broad range of factors, and generally seek to achieve a 20 percent internal rate of return on our investment and a payback period of six years or less, based on applying the statutory tax rates to the projected future earnings of the potential acquisition target. Of course, these are guidelines – not hard and fast rules – and every acquisition involves a significant element of judgment on the part of our senior leadership or board. But these financial guidelines have allowed us to stay disciplined in our acquisition strategy, and we are proud that – while not every acquisition has paid off – overall our strategy has succeeded, and on the whole we have surpassed these financial targets.

Related to this principle, we generally do not participate in M&A auctions. Most of our acquisitions have involved private companies that were not in the process of being "auctioned off" to the highest bidder. Of course, in some instances, our interest in a company has provoked a bidding situation. But when that has occurred, we have remained disciplined – completing acquisitions only when they made sense for us, and abandoning them when they do not. To that end, we have walked away from acquisition opportunities when we did not believe that they made sense for our company. For example, we abandoned efforts to acquire the specialty drug maker Cephalon when Teva raised its bid to a price that we thought no longer justified our acquisition of the company. Similarly, we abandoned efforts to acquire ISTA Pharmaceuticals, a U.S.-based ophthalmology company, that was ultimately acquired by Bausch & Lomb in 2012, when the transaction could not be completed on a favorable timetable. And most recently, we abandoned our efforts to acquire Allergan when Actavis offered a price for Allergan that we thought did not make sense for us given the returns we aim to earn from our acquisitions.

Finally, to realize the potential from our acquisitions, we move swiftly to integrate the acquired business into Valeant's decentralized operating model. Like with all corporate M&A, that often involves the elimination of certain types of jobs – generally administrative and headquarter-type positions – where there is duplication across the newly-combined businesses. But our ultimate goal is to grow the businesses we acquire, and as we grow those businesses we add manufacturing jobs and sales personnel to serve our growing businesses. As noted above, our workforce survey confirms that our employees have a high degree of job satisfaction. And our data prove this, with the average tenure of our U.S.-based hourly employees, who take home an average salary of about $41,100, at 11 years, and the average tenure of our U.S.-based salaried employees, who take home an average salary of about $105,400, at 6 years.

Our consistent adherence to these core principles is evidenced in the most significant transactions we have completed in the past five years.

The first such transaction was the 2010 combination of Valeant and Biovail that gave birth to Valeant as it exists today. In that transaction, legacy Valeant, a U.S. company, undertook a merger of equals with Biovail, a Canadian company. Biovail acquired legacy Valeant, with Biovail's shareholders receiving slightly more than half of the shares of the combined company, and Valeant's shareholders receiving slightly less than half. Although Biovail acquired Valeant, the board of the combined company decided to adopt Valeant's name in part due to reputational challenges experienced by Biovail. Given the success of legacy Valeant to that point and the approach and experience of legacy Valeant's management, legacy Valeant's senior management was retained to lead the combined company. This was a transformative merger that provided the combined company with the scale, financial strength and complementary product lines to pursue substantial growth opportunities. With Biovail acquiring legacy Valeant, the combined company was able to enjoy the benefits of Biovail's more efficient operating structure, as a Canadian company with a significantly lower effective tax rate. But this was not an "inversion" where a large U.S. company expatriates for no real reason other than to lighten its tax burden. Both companies had compelling strategic reasons for this merger. By combining Biovail and legacy Valeant, we were able to build on the strengths of each company and leverage our complementary product lines due to overlapping product areas in overlapping geographies, allowing us to deliver double-digit top and bottom line growth for our combined shareholder base. For example, both Biovail and legacy Valeant had Canadian businesses of about $100 million in revenues, and by bringing those businesses together and at the same time eliminating redundancies to achieve significant cost synergies, we were able to turbo charge the growth of our combined Canadian platform. In the United States, Biovail and legacy Valeant both focused on the neurology and dermatology markets, further supporting the strategic rationale for a merger that would result in a stronger and better positioned combined company that would compete in areas where both companies had pre-existing presences.

Shortly after Biovail acquired legacy Valeant, we completed two significant transactions in 2011 that expanded our European footprint. The acquisitions of PharmaSwiss, which was headquartered in Switzerland, and Sanitas Group, which was headquartered in Lithuania, helped to position Valeant as a leading pharmaceutical company in central and eastern Europe – a region that we viewed as prime for rapid growth. Both companies had strong generics portfolios, and as we integrated our pre-existing European business with these acquired businesses, we strengthened our presence in those important markets.

In 2012, we acquired Medicis Pharmaceutical Corporation. That acquisition was driven by our desire to expand our dermatology and aesthetics product portfolio, building upon Valeant's existing dermatology business and the research capabilities acquired in the Dow acquisition. We have long had the view that the market for dermatology products, which often are direct purchase products not subject to managed care and government-based reimbursement systems, is a high-growth business segment that would support the long-term growth of our company. In Medicis, we saw a business that was underperforming. We exceeded our synergy projections, accelerated the growth of core and under-focused products, like Ammonul, Zyclara and Vanos, and captured upside from pipeline products like Luzu that were not built into our

deal model. Moreover, as we have with many of our transactions, we retained key organizational talent and expertise that has helped us grow our overall business.

In 2013, we acquired Bausch & Lomb from a private equity firm – an acquisition that provided Valeant an opportunity to become a leading global ophthalmology company. In a relatively short time we have realized our goal of substantially enhancing the growth of the Bausch & Lomb business. When we acquired Bausch & Lomb, it was growing at a rate of approximately two percent. We are now achieving growth rates of approximately nine percent. And to ensure that our manufacturing capabilities keep up with demand, we are in the process of expanding Bausch & Lomb's manufacturing presence both here in the United States and in Ireland, growing our Bausch & Lomb-related workforce by adding more shifts and more jobs at our manufacturing facilities in Rochester and Waterford. These are precisely the types of business opportunities Valeant looks for when pursuing acquisitions, and it is very gratifying when we are able to over-deliver, as we have in the case of Bausch & Lomb.

Finally, and most recently, in early 2015 we completed the acquisition of Salix Pharmaceuticals. With this acquisition we were able to expand our therapeutic mix into gastrointestinal products, which we viewed as a growing area. And we were able to complete the acquisition at a favorable price, significantly less than others had offered just six months earlier. While it is too soon to report on the results of this acquisition, we are moving swiftly to integrate Salix into our business model, and we are optimistic that Salix will offer yet another example of a successful transaction that is helping to expand our business and provide superior returns for our shareholders.

In sum, our approach to business development has remained unchanged over the course of the past five years. We look for strategic business opportunities in growing market segments that involve acquisition targets where we think our business model can deliver significant value by enhancing the value of assets that for a variety of business reasons are under-utilized. We bring a rigorous and disciplined approach to all of our business development activity, pursuing only those opportunities that can offer us a high rate of return and rapid payback, and abandoning potential acquisitions when they no longer fit that bill. And once completed, we move swiftly to integrate those businesses into our decentralized business model that eliminates inefficiencies and fosters the growth of our acquired businesses.

The results of our strategy speak for themselves. We have deployed over $35 billion in capital in the business development transactions we have undertaken since 2008, and on an aggregate basis we have consistently exceeded our projections for both earnings and net income. While not every transaction has been a success, the largest transactions have all either been in line with or have exceeded our deal models. Across the board, the majority of our transactions are delivering above our targeted 20 percent internal rate of return, and most are returning above our cost of capital. This is good news for our employees and our shareholders.

Role of Tax Synergies in Business Development Decisions

Valeant does not take into account tax synergies in either identifying or pricing potential acquisition targets. When we perform our financial analysis of a potential transaction, we evaluate whether we believe that we can achieve our targeted 20 percent internal rate of return and six-year payback period by applying the statutory tax rates to our projections of the earnings of the target company or the assets that we are considering acquiring. We do not value proposed transactions based on the ability to achieve tax synergies and we do not pay higher prices to the sellers based on our ability to achieve tax synergies. To the extent we are able to achieve tax synergies through the integration of new businesses into our structure we believe that the benefit of those synergies should be retained for the benefit of Valeant's shareholders.

Of course, we recognize that there are tax synergies that can be achieved by integrating newly-acquired companies into our operating structure. But those synergies – to the extent they are realized – redound to the benefit of our shareholders. We do not share those tax synergies with the shareholders of companies that we acquire by paying a premium to those shareholders. That is also part of the reason why we tend to pay cash for our acquisitions; we do not like to dilute our equity by issuing new shares for each transaction. By borrowing judiciously, and using cashflow from the cost and other synergies we achieve when integrating the acquired businesses to repay debt promptly, we have been able to grow our business while providing consistently high returns to our shareholders.

In the same vein, when we decide from time to time to divest a particular business, we only do so if the divestiture makes sense to our company and for our shareholders. When we evaluate such transactions, we compare the price that a potential acquirer may be offering to the value that we can derive from the business within our corporate structure. If the potential acquirer operates in a model where they are subject to higher taxes, that means that they will need to pay us a sufficient premium to convince us to divest the business under consideration.

In connection with each major transaction that we have undertaken, we publicly disclose our efforts to integrate the acquired business into Valeant's overall structure, and we detail the anticipated synergies we expect to achieve as a result. Our disclosures typically focus on back-office workforce reductions, closing of duplicative sales offices and corporate facilities and other site rationalization actions, leveraging R&D spending, and making effective use of shared services and procurement savings. Our typical disclosures will quantify the cost synergies without regard to potential revenue synergies or the potential benefits of expanding our corporate structure to the acquired company's operations.

We realize that our approach to the role of tax synergies in M&A transactions may not be universal and that other companies may approach tax synergies differently, taking them into account in determining whether and at what price to pursue a transaction. But that is not the approach we have taken at Valeant and it is not an approach that we intend to pursue in the future. We believe that our approach to tax synergies in business development transactions – i.e., *not* taking them into account in our evaluation of M&A opportunities – has served our company and our shareholders well and we intend to continue with that approach.

Approach to Tax Synergies

As noted above, we of course appreciate that there are tax synergies to be realized through the integration of newly-acquired businesses into our structure. Those benefits generally derive from two sources – our use of debt to finance our acquisitions and our integration of the intellectual property of the acquired companies into our corporate structure.

With regard to debt financing, we often rely on third-party borrowing to finance our acquisitions. We do so because we have great confidence in the future of our company and we believe that we can offer a better return to our shareholders by using debt financing, rather than equity financing, to fund our acquisitions. Stated differently, if we believe that a business development opportunity is going to help increase the value of our shares, our strong preference is to extend that value to our shareholders, not the shareholders of the company we are acquiring. We presently have approximately $32 billion of outstanding third-party debt, almost half of which was incurred earlier this year to finance the acquisition of Salix.

This borrowing does, in turn, provide a tax benefit in the form of deductible interest expense paid by U.S. entities within our corporate group. Our U.S. affiliates have approximately $20 billion of indebtedness, some of which is through direct third-party borrowing, and some of which is through intercompany borrowing in which our Canadian parent company has borrowed funds from third-parties and on-loaned those funds, either directly or through affiliates, to our U.S. affiliates to fund acquisitions – as was the case with the recent acquisition of Salix.

The bias that the U.S. tax code – like many tax codes – provides in favor of debt financing (as compared to equity financing) is well known and is certainly not unique to non-U.S. parented companies like Valeant. But it is a feature of the tax system that we benefit from – and that provides us with tax synergies in the context of acquisitions given our preference for financing those acquisitions with debt. Unlike some other foreign based companies, however, our intercompany lending is almost always tied to particular transactions.

With regard to intangible planning, it is important to note that, like all pharmaceutical companies, our intellectual property portfolio is one of our most valued assets, and a major source of the returns we earn for our shareholders. We think very carefully about where to hold our intellectual property, where to fund the ongoing development of that intellectual property, and where to locate the attendant functions related to the commercialization of our products that embody that intellectual property. The applicable tax rates in various jurisdictions are of course a key consideration in the decisions we make regarding where to hold our intellectual property portfolio. Our team has invested significant thought into these types of questions, and each time we complete an acquisition, they move quickly to integrate the acquired business into our intellectual property ownership structure. These integration efforts are part and parcel of the overall process of combining the acquired business with our existing businesses, and are critical to the long-term success of any acquisition.

As a general matter, while I am certainly no tax expert, I am told that we have the same strategies available to us that generally are available to all multinational companies – whether U.S.- or foreign-parented. As with all U.S. companies, if and when we decide to transfer

intellectual property from a U.S. member of our corporate group to an affiliate outside of the United States, we must do so at fair market value and pay tax, either upfront or over time, associated with the value of the intellectual property or the income that results from exploiting it. In contrast to U.S. multinationals though, because Valeant is a Canadian company, we have the ability to more efficiently access earnings associated with the foreign intellectual property ownership given Canada's territorial tax system as compared to the U.S. worldwide regime. This means that we can deploy our foreign earnings where we need to, including in the United States, without paying a toll charge to access those earnings. As I understand it, the intellectual property planning that Valeant employs does involve a trade-off. To the extent that we move the ownership and ongoing development of intellectual property outside of the United States, the costs associated with that development are not borne in the United States and thus are not tax deductible here. If those development efforts do not pay off, not only do we not realize tax savings, but we actually suffer a tax cost due to lost tax deductions.

Finally, while we, like most other non-U.S. multinationals, have greater flexibility in accessing earnings of our foreign affiliates, I should note that accessing the historic foreign earnings of companies we have acquired has not been a material feature of the tax synergies related to the transactions we have undertaken.

Savings Realized Through Tax Synergies

A key facet of Valeant's acquisition strategy is to swiftly integrate the acquired company with our existing business and structure. Because intellectual property tends to be a major component of value of the businesses we acquire, the post-acquisition integration efforts we have undertaken often involve migrating the risks and rewards associated with intellectual property rights within our corporate structure so that we can maximize the returns on those intellectual property rights for our shareholders.

For example, after we acquired Medicis in December 2012, we licensed all of the legacy Medicis intellectual property rights to our Canadian parent company in exchange for an arm's-length royalty, and then migrated many of those rights from Canada to Ireland. These transactions shifted the future risk of developing the acquired intellectual property outside of the United States, but at the cost of the royalties that were required to be paid back to our U.S. consolidated group.

The Bausch & Lomb transaction was our largest acquisition at the time, and our team used the integration process to establish an Irish affiliate as a principal company responsible for ongoing development and exploitation of Valeant's overall intellectual property portfolio. Specifically, a number of existing Valeant assets and entities were contributed to an Irish affiliate, and the legacy Bausch & Lomb intellectual property, together with other Valeant intellectual property, including the legacy Medicis intellectual property rights, was contributed into that same Irish principal company. Going forward, the Irish principal company and other Irish affiliates within the Valeant group contract with affiliates or third parties to manufacture products using its intellectual property rights, and contracts with affiliates to distribute those products in the markets in which we operate.

Building on the structure put in place following our Bausch &Lomb acquisition, we expect that Salix and certain Salix affiliates will license their intellectual property to our Irish principal company in exchange for royalty payments based on the sales of the licensed products. As with the other intellectual property held by our Irish principal company, it is that entity that will bear the costs and risks associated with the ongoing development and commercial exploitation of that intellectual property.

For each of these integration exercises, while we projected the possibility of significant savings, the ability to achieve those savings in each instance depended on the success of the business, which given the business we are in is always an uncertain proposition. As noted above, projected tax savings of this sort are not factored in the price that we agree to pay to acquire a company. And once we implement the integration planning, we do not track what our taxable income might have been had we not undertaken those steps. Rather, once we integrate a company into our structure we simply have a new overall tax rate for the combined companies and we evaluate the performance of the newly-acquired business based on its growth and taking into account that new, combined effective tax rate.

Views on Corporate Tax Reform

I am a former investment banker and have devoted most of my career to advising clients on the allocation of capital and strategic transactions. I am not a tax expert, and cannot speak to the specifics of any particular aspect of tax reform. Nor can I say that Valeant – as a company – has developed any particular views regarding U.S. corporate tax reform.

That said, I can speak to those features of the Canadian tax system which we, as a Canadian company, have found conducive to our growth and success in the highly competitive, global pharmaceuticals industry.

First, Canada has a tax rate that is in line with many other developed countries. The Canadian federal corporate tax rate is 15 percent, and the provincial tax rates range from 3 to 16 percent. For Valeant, given where we operate in Canada, our blended statutory tax rate in Canada is about 26.2 percent, as compared to the combined federal and state statutory tax rate of approximately 36 percent that we face in the United States.

Second, Canada, like most other developed countries, has a territorial tax system in which Canada taxes corporations on their Canadian income but not on the non-Canadian income earned by non-Canadian subsidiaries. We therefore do not face a Canadian "toll charge" when we repatriate earnings to our Canadian parent. This allows us to efficiently access and deploy capital throughout our corporate group, including in the United States, without facing the prospect of having "trapped cash" that, for tax reasons, cannot be put to its highest and best use.

Third, like most other developed countries, Canada has a controlled foreign corporation regime under which some types of non-Canadian income earned by our non-Canadian subsidiaries will be taxed in Canada. But the Canadian CFC rules are narrowly crafted to prevent specific abuses and do not operate to subject broad swaths of non-Canadian income to Canadian taxation, nor do they meaningfully interfere with our preferred business operating model. Taken together with its territorial tax regime, this feature of the Canadian tax system,

which I understand is broadly consistent with the corporate tax systems used by most developed economies other than the United States, make Canada a favorable headquarters location for a global pharmaceuticals company like Valeant.

* * * * *

Thank you again for the opportunity to appear before the Subcommittee today. I would be pleased to try to answer any questions that you may have regarding the topics addressed in my testimony.

Statement of Joshua Kobza, Chief Financial Officer
Restaurant Brands International
for the
Permanent Subcommittee on Investigations,
U.S. Senate Committee on Homeland Security
July 30, 2015

Chairman Portman, Ranking Member McCaskill and Members of the Subcommittee:

My name is Josh Kobza. I currently serve as Chief Financial Officer (CFO) of Restaurant Brands International (RBI) and most recently worked in the same capacity at Burger King Worldwide (Burger King). I am here today to discuss the recent Burger King-Tim Hortons transaction, which created one of the world's largest "quick service restaurant" (QSR) chains. I understand that the Subcommittee is reviewing the effect of the corporate tax code on U.S. businesses and on cross-border mergers and acquisitions. While this transaction, like all cross-border combinations, had certain tax implications, the marriage of these two iconic brands of similar size under the RBI umbrella was motivated by compelling business reasons rather than tax strategies.

And now, about seven months after closing our transaction, I'm pleased to report that the combined company has been performing beyond our expectations prior to the combination. Both brands are experiencing some of the best growth they've had in years, across each of their large markets. In particular, Burger King has had its best sales growth in the U.S. in approximately ten years, with same store sales up approximately 8% in the latest quarter and is seeing significant growth in franchisee profitability. Tim Hortons has also continued to accelerate its growth in Canada, while bringing greater resources and focus on growing Tim Hortons outside of Canada, particularly in the U.S., which we view as our largest growth opportunity in the world.

Burger King & Tim Hortons: Two Iconic Brands with Complementary Footprints

From the beginning, our vision centered on combining two iconic brands that occupy a distinct space in the QSR landscape—both geographically and in their menu offerings—to create new and exciting opportunities for the future.

Burger King is the world's second largest fast food hamburger restaurant, with over 14,000 restaurants in approximately 100 countries and U.S. territories. Burger King's restaurants are limited service restaurants that feature flame-grilled hamburgers, chicken and other specialty sandwiches, french fries, soft drinks and other affordably-priced food items. During Burger King's nearly 60 years of operating history, the company has developed a scalable and cost-efficient quick service hamburger restaurant model that has been replicated all over the world.

Tim Hortons is the largest Canadian-based QSR and has nurtured a strong and loyal customer base, with approximately 45% of all QSR traffic in Canada occurring at a local Tim Hortons. The first restaurant was opened in 1964 by Tim Horton, a National Hockey

League All-Star defenseman. Tim Hortons appeals to a broad range of consumer tastes, with a menu that primarily focuses on premium blend coffee and a broad selection of breakfast items and snacks—including donuts, Timbits® and other fresh baked goods. Tim Hortons strong breakfast menu is a particularly important asset given that breakfast is one of the fastest growing categories in QSR and is a highly complementary offering to Burger King's menu in the U.S.

Our new RBI family now includes over 19,000 restaurants in approximately 100 countries. The geographic breadth outside of North America is largely attributable to a concerted effort by Burger King to expand its international presence in order to secure long-term growth in new markets. Today, more than half of Burger King's restaurants are located outside the U.S. While Tim Hortons previously has had a limited footprint outside of Canada, we see a significant opportunity to grow this iconic brand and unique operating model in attractive markets all around the world, beginning in the U.S.

Building a Platform for Jobs & Growth

The transaction with Tim Hortons can be traced back to mid-2013, when our senior management team began to evaluate future alternatives for growth and enhancement of shareholder value, including potential strategic transactions. As part of this effort, we explored the possibility of acquiring another company in the QSR space, which would benefit from our expertise and complement our market presence.

Through our search for a brand that would complement our business and create additional opportunities for growth, we identified Tim Hortons as an excellent choice—a high-quality business with an incredibly strong brand and complementary menu offerings, where we could add significant value by leveraging Burger King's worldwide operating partner networks and experience in global development.

Due to the highly iconic nature of each brand, we structured the transaction in a way that honored the history and roots of both companies. Specifically, Burger King's headquarters remains in Miami, Florida and Tim Hortons remains in Oakville, Ontario, with separate management to ensure the integrity of each brand. Burger King is committed to its home state of Florida and to the approximately 300 employees associated with its global headquarters, as well as the field employees who assist local franchisees across the country.

We were convinced that the pairing of both brands would unlock significant opportunities to promote jobs and growth in the U.S., while leveraging greater global scale and savings to benefit customers and franchisees.

On this point, I am pleased to report that with the transaction closing behind us, we are working hard to grow the Tim Hortons brand in the U.S., which will continue to create new franchise opportunities and jobs, as well as an expanded U.S. tax base, in the future. We plan to open hundreds of new restaurants across the U.S. market, attracting tens of millions of dollars in investment and creating thousands of new jobs.

Business Realities Drove this Deal Forward

As CFO during discussions between Burger King and Tim Hortons, I was responsible for working with our professional advisors to explore how to structure a potential transaction. As these structuring discussions progressed, it became clear that a combined Burger King-Tim Hortons company should be domiciled in Canada.

The business case for this transaction was always clear to us, and closing the deal required careful calibration of the terms and structure of the transaction. Both the Tim Hortons brand and the Burger King brand are revered institutions in their country of origin. But given that Canada is the country with the highest concentration of employees, assets and income for the combined company, Canada was the logical choice to be the domicile of the newly formed entity.

Additionally, the Board of Directors for Tim Hortons at first declined to discuss any possible combination and was reluctant to engage in serious negotiations until our proposal contained both a higher price and commitment to locating the combined company in Canada. Throughout our discussions with the company's board and management, it was made clear to us that domiciling the company in Canada was critical to concluding the deal.

Under the transaction, Burger King remains a U.S. taxpayer with an unwavering commitment to our Miami headquarters, the surrounding community and our U.S. franchisees. When compared to the 26% effective tax rate paid by Burger King prior to the transaction, our current effective tax rate is only slightly lower—in the range of a 3% rate reduction. This modest impact underscores a crucial point: joining Burger King and Tim Hortons together was fundamentally about growth. Tax considerations were never the driving force for our transaction. Rather, our primary motivation was to realize the greater business potential of combining these two iconic and complementary brands. As a combined company, we are focused on accelerating our growth. Our goal continues to be to grow our business and our brands alongside our franchisees, employees and other partners over the long-term.

In closing, we understand that in recent years, the policy discussion regarding the role of tax considerations in corporate mergers and acquisitions has become more prevalent. In this regard, we welcome the ongoing bipartisan efforts to make the U.S. tax system more competitive to level the playing field.

IMPORTANT RECORD PAGES

[redacted]

PRELIMINARY - AS OF 2/5/15

Base case 1

[redacted]

IRR sensitivity to price and tax rate

@1% terminal growth	Purchase price				
	$140	$145	$150	$155	$160
5%	24.50%	24.00%	23.40%	22.90%	22.40%
10%	23.50%	23.00%	22.40%	21.90%	21.40%
36%	17.50%	17.00%	16.50%	16.10%	15.60%

IRR sensitivity to price and terminal growth

@36% tax	Purchase price				
	$140	$145	$150	$155	$160
-10%	10.80%	10.30%	9.80%	9.30%	8.90%
-5%	12.90%	12.40%	11.90%	11.50%	11.00%
0%	16.50%	16.00%	15.50%	15.10%	14.60%
1%	17.50%	17.00%	16.50%	16.10%	15.60%

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Pursuant to Senate Rule XXIX

Summary of Valuations (US Tax Rate 36%)

USD (M)	Base	Conservative	Upside
NPV (Standalone)	1,312	631	2,697
PV of Business	827	526	1,519
TV	485	105	1,178
Synergy NPV	2,439	2,147	2,358
Synergized NPV	3,613	2,640	4,913
NPV @ $44/Share	981	9	2,281
IRR	14%	9%	19%
Payback undiscounted	9.1	10+	6.2

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Summary of Valuations (Tax Rate 20% - TBD)

USD (M)	Base	Conservative	Upside
NPV (Standalone)	1,403	521	3,152
PV of Business	903	515	1,779
TV	500	7	1,373
Synergy NPV	3,118	2,754	3,018
Synergized NPV	4,352	3,107	5,996
NPV @ $44/Share	1,721	476	3,364
IRR	17%	12%	23%
Payback undiscounted	7.2	9.1	5.0

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VRXPSI-01-0000093

Transaction Structure – Tax Perspective

An inversion reduces Blue's tax rate and allows for efficient access and distribution of global cash

- Blue currently has a book effective tax rate of 28.5%, which is materially lower than the U.S. corporate tax rate due to offshore IP holdings. However, offshore earnings cannot be repatriated to the U.S. without incurring material additional tax expense
- As we have transitioned to a fully-franchised business model with lower capital expenditures and realized significant earnings growth in EMEA and APAC, cash balances have increased to >$250mm today
- If Blue were to repatriate these cash balances, its corporate tax rate would likely increase to near 40%
- Blue offshore cash balances are expected to grow significantly in 2014 and subsequent years
- [redacted]
  - [redacted]
  - [redacted]
  - [redacted]
  - [redacted]
- [redacted]

Investment Overview (continued)

1. Attractive Business: [redacted]

2. Actionable Today: [redacted]

3. Meaningful Value Creation: [redacted]

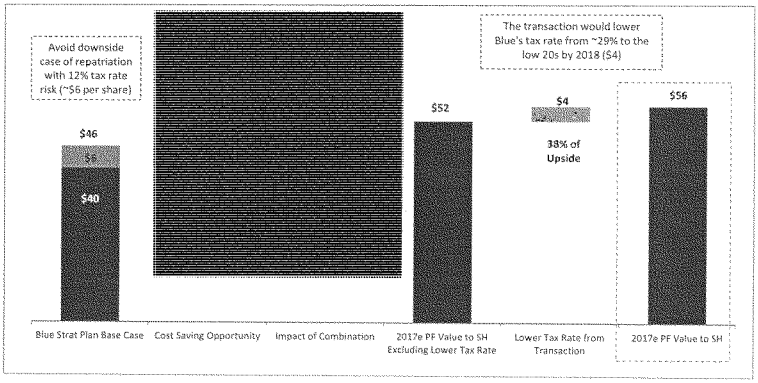
4. Cost Opportunity: [redacted]

5. Tax Optimization: **value creation through tax at company and shareholder levels**

- Utilize currently-available inversion rules to move Blue offshore, reduce Blue's corporate tax rate, and tax-efficiently access non-U.S. cash
- Would reduce current tax rate of 29% to the low to mid 20's in the medium term vs. potential downside of 40% on a standalone basis
- Incremental value creation from tax equates to $1.4bn vs. status quo and $5.5bn vs. a scenario where cash is repatriated

We Continue to See ~50% ($4bn) Incremental Value Creation

2/3rds of additional value is from fundamentals, leverage, and cost savings, while 1/3rd is from tax savings



Note: Assumes forward P/E multiple of 21x earnings.

United States Senate
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
Committee on Homeland Security and Governmental Affairs
Rob Portman, Chairman

IMPACT OF THE U.S. TAX CODE ON THE MARKET FOR CORPORATE CONTROL AND JOBS

MAJORITY STAFF REPORT

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

UNITED STATES SENATE

IMPACT OF THE U.S. TAX CODE ON THE MARKET FOR CORPORATE CONTROL AND JOBS

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EXECUTIVE SUMMARY

The Senate Permanent Subcommittee on Investigations recently examined the effect of the U.S. tax code on the market for corporate control of American companies. The United States has the highest corporate tax rate in the industrialized world, and (alone among its peers) has retained a worldwide system that taxes American companies for the privilege of repatriating their overseas earnings. Meanwhile, most other nations with advanced economies have adopted competitive tax rates and territorial-type tax systems. As a result, U.S. firms too often have a significant incentive to relocate their headquarters overseas. Corporate inversions may be the most dramatic manifestation of that incentive, but the far greater part of the story concerns other more common forms of cross-border mergers and acquisitions.

Through a detailed review of several important cross-border transactions, our investigation found that the increase in after-tax profits created by escaping the U.S. tax net can (i) contribute significantly to foreign corporations' ability to acquire American firms; and (ii) create powerful incentives for American firms that merge with foreign corporations to locate their new combined headquarters abroad. Both phenomena can lead to a significant loss of American jobs, business headquarters, and tax revenues.

First, the Subcommittee examined three major acquisitions of U.S. companies by Valeant Pharmaceuticals, a successful, serial acquirer headquartered in Quebec. Since merging with a Canadian firm and relocating to Canada, Valeant has achieved a single-digit cash effective tax rate; according to its longtime CFO, that rate has "turbocharged" Valeant's expansion by acquisition,[1] making it the sixth-largest OECD-based foreign acquirer of U.S. companies in terms of deal price, according to third-party data compiled by the Joint Committee on Taxation. When evaluating an acquisition, Valeant considers many factors but focuses on two key deal targets: the projected internal rate of return it can expect, and the "payback" period of the acquisition—the time it will take Valeant to recover its investment. As a guideline, Valeant generally seeks deals projected to achieve a 20% internal rate of return and a payback period of 6 years or less.

[1] Subcommittee Interview of Howard Schiller, Corporate Dir., Valeant Pharm. Inc. (July 24, 2015). Schiller elaborated: "I think the clear answer is that what really distinguishes Valeant is its ability to create value [through its business model]. . . . But its tax rate has augmented its growth. There is no question that we would not be in the same place we are in today if we had a higher tax rate. We have been able to plow that [after-tax profit] back in at very high rate of return."

To understand the role of tax considerations in Valeant's deals, PSI reviewed Valeant's recent multibillion-dollar acquisitions of three U.S. companies: Medicis, Bausch & Lomb, and Salix. Valeant's primary valuation of target companies was based on an assumed U.S. tax rate of 36%—close to the U.S. target companies' actual or projected rates. In each transaction we reviewed, however, Valeant performed a pre-acquisition tax analysis to determine the lower tax rate that could be achieved by integrating its U.S. target into Valeant's corporate group headquartered in Canada. Applying that new, lower tax rate to the U.S. company's future cash flow, Valeant evaluated the deal along the two key guidelines mentioned above—whether it could meet (or approximate) its targeted 20% return and 6-year payback period. In each case, Valeant's ability to hit or approximate those targets depended to a large extent on its ability to lower the target company's tax rate. In other words, tax savings helped justify the price that Valeant was able to pay while hitting its ambitious financial goals. Valeant's projected post-acquisition tax savings for Bausch & Lomb alone exceeded $3.6 billion over 10 years, and its projected tax savings for Salix exceeded $560 million over 5 years. And although Valeant did not project specific tax savings for Medicis, we estimate the potential savings at approximately $680 million over 10 years.

It is important to note that none of these acquisitions were "tax-motivated" in the sense that Valeant was aiming to reduce its own tax liabilities. Instead, they illustrate that foreign acquirers that hail from more favorable tax jurisdictions are able to create value *simply* by restructuring the affairs of the U.S. target companies to improve their tax profile. In Valeant's case, those tax savings significantly enhanced the deal along the key metrics that Valeant uses to decide whether to undertake an acquisition.

Second, the Subcommittee examined a major transaction that can be thought of as a "merger of equals": Burger King's $11.4 billion merger with the Canadian restaurant business Tim Hortons. Our review showed that Burger King had clear business reasons to team up with Tim Hortons. But when deciding where to locate the headquarters of the combined firm, tax considerations flatly ruled out the United States from the outset. Burger King calculated that pulling Tim Hortons into the worldwide U.S. tax net, rather than relocating to Canada, would destroy up to $5.5 billion in value over just five years. Far better, executives concluded, to put the new company in a country that would allow it to reinvest overseas earnings back in the U.S. and Canada without incurring new taxes.

Finally, the Subcommittee conducted a limited review of the tax and employment consequences of InBev's 2008 acquisition of Anheuser Busch. Through

that deal, InBev was able to integrate a U.S. company with a pre-acquisition worldwide effective tax rate of approximately 39% into a worldwide corporate group with an effective tax rate of 19%. It is clear from the record that a significant number of U.S. jobs were lost following that acquisition. From 2007 to 2015, the number of U.S.-based employees of AB InBev declined by about 30%, while the number of employees based in Leuven, Belgium and the State of São Paulo, Brazil rose by 34%. In particular, the company's U.S. headcount was reduced from 18,345 in 2007 to 12,938 in 2015. That 30% reduction is significantly higher than the 10% to 15% decrease that Anheuser-Busch announced before the merger as part of its restructuring plan.

* * *

The lesson policymakers should draw from our findings is straightforward: The high U.S. corporate tax rate and worldwide system of taxation are competitive disadvantages that make it easier for foreign firms to acquire American companies. Those policies also strongly incentivize cross-border merging firms, when choosing where to locate their new headquarters, not to choose the United States. The long term costs of these incentives can be measured in a loss of jobs, corporate headquarters, and revenue to the Treasury.

BACKGROUND

To place the case studies that follow in context, we begin by briefly outlining the basic elements of the U.S. corporate tax code. We then turn to an overview of recent empirical research and academic commentary concerning the effect of the U.S. tax code on the ability of U.S. businesses to grow by acquisition, along with the tax advantages enjoyed by foreign acquirers in the market for corporate control. Finally, we describe the means by which foreign acquirers are often able to reduce the tax burden on U.S. firms.

The U.S. Corporate Tax System

America's approach to taxing corporate income is an outlier among industrialized nations. The United States has the highest statutory corporate tax rate among Organization for Economic Co-operation and Development (OECD) countries—a 39% combined state and federal rate,[2] well above the OECD average of

[2] *Table II.1. Corporate Income Tax Rate*, OECD.STAT (2015), http://stats.oecd.org//Index.aspx?QueryId=58204 (last visited July 27, 2015).

25%.[3] Even with a panoply of tax preferences that narrow the U.S. tax base, the average effective tax rate paid by U.S. corporations is still seven points higher than the OECD average effective rate.[4]

The United States is also one of few nations that has not yet adopted a territorial system of taxation.[5] Instead, U.S. corporate income taxes apply worldwide. For financial accounting purposes, U.S. corporations can defer recording U.S. tax expense for the overseas earnings of their foreign subsidiaries by declaring such earnings to be permanently reinvested. As a consequence, apart from certain passive income subject to immediate taxation and cross-border related party sales and services income,[6] U.S. corporations can defer U.S. tax on their overseas earnings indefinitely, both for tax and financial accounting purposes. These earnings are then effectively "locked out" of the U.S., due to the interaction of tax law and accounting standards.[7] As of this year, U.S. corporations have accumulated approximately $2.1 trillion dollars in locked-out overseas earnings—a sum increasing at an annual rate of about 8%.[8]

In contrast to the U.S. system, most of our major trading partners—including every other G-7 nation—have adopted territorial tax regimes, meaning that they tax business income earned within their borders but largely exempt business income earned outside their borders. Canada, for example, does not tax the overseas earnings of Canadian-owned businesses, so long as the earnings are derived from an active business in a country with which Canada has an income tax treaty or other qualifying agreement. As a result, unlike U.S. businesses, Canadian firms doing business abroad can simply pay taxes owed in the countries where they

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[3] *Id.*

[4] *See* DUANJIE CHEN & JACK MINTZ, TAX FOUND., THE U.S. CORPORATE EFFECTIVE TAX RATE: MYTH AND FACT, 7 (Feb. 2014), *available at* http://taxfoundation.org/sites/taxfoundation.org/files/docs/SR214.pdf.

[5] We use the shorthand "territorial" to describe systems of taxation that exempt foreign business income from resident-country taxation.

[6] Subpart F of the tax code requires immediate taxation of most passive income, such as income and royalties. Subpart F income forms the principal exception to the deferral regime that governs most overseas income.

[7] The Senate Finance Committee's International Tax Reform Working Group recently released a report that provides a fuller treatment of the U.S. taxation of foreign earnings. *See* Senate Fin. Comm., Int'l Tax Reform Working Group: Final Report 15–55 (July 2015), *available at* http://www.portman.senate.gov/public/index.cfm/files/serve?File_id=923a866b-9c71-429a-a655-5dd0adef2caa.

[8] *Id.* at 78.

operate, and then repatriate those earnings to Canada without incurring additional tax.[9]

Taxes and the Market for Corporate Control

Businesses buy and merge with other businesses primarily because of "ownership advantages"—the means by which an acquirer expects to create new value.[10] Those advantages may take a number of forms. An acquirer might believe it can boost a target company's profits through cost-cutting, improve sales through better marketing, or enhance productivity by integrating complementary technologies. An acquirer expects that its ownership advantages will increase the target firm's future cash flow, thus "enabling the acquirer to outbid the reservation price of the initial owner[s] and increase the likelihood that the deal takes place."[11] In other words, ownership advantages allow the acquirer to pay a premium—more than the target firm is valued by the market as a whole.

There is a growing body of evidence that simply being a non-U.S. acquirer—with access to a lower corporate tax rate and territorial system of taxation—has become a significant ownership advantage. In a recent paper, Professor Andrew Bird of Carnegie Mellon University reported strong empirical evidence that "U.S. based potential acquirers for U.S. targets are losing out to foreign acquirers who are tax-favored"—that is, foreign acquirers headquartered in countries with a territorial regime and a low corporate tax rate.[12] Bird found that the ability to access "locked-out" foreign earnings of U.S. firms drives foreign acquisition, and that the effect is strongest for foreign acquirers who have access to a territorial system:

> If U.S. firms retain greater levels of foreign earnings overseas as a result of the U.S.'s worldwide tax system and the related financial reporting rules, these U.S. firms become more attractive targets for foreign buyers as the foreign buyers enjoy

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[9] ERNST AND YOUNG, CANADA-HONG KONG TAX TREATY ENTERS INTO FORCE 1 (Oct. 30, 2013), *available at* http://www.ey.com/Publication/vwLUAssets/Tax_Alert_2013_No_50/$FILE/TaxAlert2013No50.pdf.

[10] THOMAS BELZ ET AL., TAX AVOIDANCE AS A DRIVER OF MERGERS AND ACQUISITIONS 1 (December 23, 2013) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2371706.

[11] *Id.*

[12] Andrew Bird et al., *Does the U.S. System of Taxation on Multinationals Advantage Foreign Acquirers?* 35 (Rotman Sch. of Mgmt., Working Paper No. 2550819, 2015), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2550819.

> a tax-advantage resulting from the acquisitions. The tax-advantage is created by two primary factors. First, foreign acquirers have a tax-advantage related to locked-out past earnings of the U.S. multinational targets. Through the merger or acquisition a foreign acquirer may be able to free the multi-national's foreign subsidiaries' past earnings from the U.S. worldwide tax system by accessing those past earnings through 'out-from-under' strategies. Second, the foreign acquirer can exploit an additional tax-advantage on a go forward basis. With appropriate tax planning, future foreign (e.g., non-U.S.) earnings of the new entity could avoid or lower U.S. repatriation taxes that would exist under the old corporate structure.[13]

Based on a sample of more than 4,500 acquisitions of U.S. corporations from 1996 through 2010, Bird determined that "the baseline likelihood of an acquirer of a U.S. corporation being foreign is 17%," but it rises to 23% if the U.S. target has foreign earnings/operations.[14] In a related 2014 study, Bird found evidence that the more profitable a U.S. target firm is, the more likely it will be acquired by a foreign corporation rather than a U.S. firm. Bird explained that "the empirical results show that foreign acquirers systematically target more profitable firms for acquisitions," and "[a]s would be expected if this observation is driven by tax differences, the results are strikingly larger for tax haven-resident acquirers."[15]

Other researchers have reached similar conclusions. In 2009, economists at Tilburg University conducted an analysis of cross-border M&As involving the United States, Japan, and several European countries from 1985-2004.[16] They found that "countries can attract additional parent companies by lowering international double taxation, either through lower tax rates or through more generous double tax relief"—that is, through reducing taxes on repatriation of

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[13] *Id.* at 4.

[14] *Id.*

[15] Andrew Bird, Domestic Taxes and Inbound Acquisitions 35 (July 6, 2015) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2627367. Bird also reported that U.S. firms with access to greater domestic tax deductions are less likely to be the target of inbound foreign merger and acquisition activity. *Id.* at 35–36.

[16] *See* Harry P. Huizinga & Johannes Voget, *International Taxation and the Direction and Volume of Cross-Border M&As*, 64 J. OF FIN. 1217 (June 2009) *available at* http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.2009.01463.x/full.

foreign earnings.[17] Their study notes that high repatriation taxes decrease the likelihood that a nation will host the corporate headquarters of a domestic firm that merges with a foreign one. In the same vein, a related 2009 study concluded that multinational corporations that face high repatriation taxes, like U.S. businesses, are significantly more likely to relocate through merger and acquisition. The study's author urges policymakers to "consider that firms may vote with their feet and relocate headquarters" if their home-country system of taxation remains uncompetitive.[18]

As many industrialized nations have reformed their tax codes in recent years, experts have evaluated the effect of those reforms on the ability of businesses to grow by acquisition. A 2013 study by scholars at the Centre for European Economic Research examined the impact of Japan's 2009 decision to switch from a worldwide to a territorial system of taxation.[19] The results were striking. Based on a large sample of cross-border mergers and acquisitions, the study found that Japan's reform "increased the number of foreign acquisitions by Japanese firms by 31.9%."[20] The study also simulated the effects of a U.S. transition to a territorial system and concluded that it would "increase . . . the number of international mergers and acquisitions with U.S. acquirers by 17.1%."[21] The study's authors explained that "[r]epatriation taxes to be paid on a target's profits" reduce the valuation of the target and, consequently, "the bid price of U.S. investors is relatively lower than that of an identical investor from a [territorial] country."[22]

Most recently, a 2015 study prepared by Ernst & Young for the Business Roundtable attempted to estimate the impact that a lower corporate tax rate would have on U.S. businesses' ability to grow by acquisition. From 2004–2013, U.S. companies were the acquirers in 20% of cross-border M&A activity by value and the

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[17] *Id.* at 1237.

[18] Johannes Voget, *Headquarter Relocations and International Taxation* 2 (Oxford Univ. Ctr. for Bus. Taxation, Working Paper No. 10/08, 2009) *available at* http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Working_Papers/Series_10/WP1008.pdf.

[19] *See* Lars P. Feld, *Effects of Territorial and Worldwide Corporation Tax Systems on Outbound M&As* 1 (Ctr. for Econ. Studies & Ifo Inst., Working Paper No. 4455, 2013) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2353329.

[20] *Id.* at 20.

[21] *Id.* at 2.

[22] *Id.* at 1. Other scholars have focused on a related investment distortion caused by the U.S. tax system's lock-out effect: ["Edwards et al. (2014) and Hanlon et al. investigate the effect of cash trapped overseas on U.S. multinational corporations' foreign acquisitions and find that firms with high levels of trapped cash make less profitable acquisitions of foreign target firms using cash consideration."]

target in 23% by value. Based on a review of 24,000 cross-border M&A transactions across 34 OECD countries, the report found that the United States would likely have been a net acquirer—rather than a net target—if the corporate rate were 25% (the OECD average).[23] Specifically, "[w]ith a 25% tax rate, US companies would have acquired $590 billion in cross-border assets over the past 10 years instead of losing $179 billion in assets (a net shift of $769 billion in assets from foreign countries to the United States)."[24] The report also estimated that a 25% corporate tax rate would have "kept 1,300 companies in the U.S. over the last 10 years."[25]

Tax-based distortions of the market for corporate control raise serious economic concerns. Ownership of a business is, of course, "an important determinant of its productivity."[26] Professor Bird explains that "if some potential acquirers have a purely tax-derived comparative advantage in acquiring certain assets, they may be able to outbid other potential acquirers that could make more productive use of the assets."[27] In other words, tax distortions can produce inefficiencies, driving U.S. businesses into the hands of those best able to reduce tax liabilities, rather than those best equipped to manage and grow them—and thereby create jobs and increase wages. Bird notes that "[s]ince an acquirer's post-deal tax savings are completely offset by government revenue losses at the global level, such a situation represents a clear deadweight loss, as the real productivity of the stock of assets is not maximized."[28]

Post-Acquisition Tax Planning

The tax advantages available to acquirers from other OECD nations derive principally from their comparatively lower domestic corporate tax rates and territorial systems of taxation. Those advantages do not, however, automatically transfer to the U.S. target company after an acquisition. Even if a U.S. target's new parent is headquartered abroad, the U.S. target company itself remains a tax resident of the U.S., and the U.S. target's foreign subsidiaries are still members of a U.S. corporate group. Consequently, a foreign acquirer must engage in some

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[23] ERNST AND YOUNG, BUYING AND SELLING: CROSS-BORDER MERGERS AND ACQUISITIONS AND THE US CORPORATE INCOME TAX i (March 2015), *available at* http://businessroundtable.org/sites/default/files/reports/EY%20BRT%20Cross-border%20MA%20report%202015%2003%2010.pdf.
[24] *Id.*
[25] *Id.*
[26] Bird, *supra* note 12, at 1.
[27] *Id.*
[28] *Id.*

combination of tax planning and business reorganization to significantly reduce the tax burden on an acquired U.S. company.

On a long-term basis, a foreign acquirer can reorganize a U.S. firm so that "future foreign earnings of the pre-existing U.S. foreign subsidiaries are no longer subject to U.S. tax."[29] That can be achieved through essentially "freezing" the value of the U.S. target firm's foreign subsidiaries and the transferring of assets to non-U.S. affiliates of the foreign parent.[30] This so-called "out-from-under" planning is "highly fact specific and different strategies are used depending on the attributes of the firms involved."[31] The effect, however, is to incrementally pull the target firm's non-U.S. business activity out from under the U.S. tax net, thereby freeing its overseas income from repatriation taxes.

Foreign acquirers can use other common tax-planning tools to more quickly reduce tax rates on U.S. firms after an acquisition. Foremost among them is the transfer of intellectual property to lower-tax jurisdictions and the use of intercompany debt. Post-acquisition transfers of intellectual property—whether by sale or license—result in taxable income for the acquired U.S. firm. Under section 482 of the tax code, a business that transfers intellectual property to a related party (*e.g.*, a foreign affiliate) must be compensated at an arms-length rate—one based on the property's estimated market value. The effect of such intellectual property transfers, however, is to move important income-generating assets *out* of the U.S. group and into affiliates located in low-tax jurisdictions. Although the U.S. group will be compensated for the intellectual property as it was valued at the time of transfer, the foreign acquirer can source future income on that intellectual property outside the U.S. tax net—including income from business improvements that increase the value of the transferred intellectual property.

In addition, the Subcommittee reviewed a number of transactions in which the foreign acquirer has used acquisition debt to reduce the tax base of the U.S. target firm. Typically, the foreign firm will borrow from third-party banks at the foreign-parent level, and then push down some or all of that debt onto the balance sheet of the U.S. target company through an intra-group loan. The U.S. target is then able to make significant deductible interest payments to the foreign parent (or to a low-taxed subsidiary of the foreign parent)—subject to little or no U.S. federal withholding tax, depending on treaty arrangements. This strategy reduces the U.S.

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[29] Bird *supra* note 12, at 15.
[30] *Id.*
[31] *Id.* at 14.

target's tax base in a high-tax jurisdiction, while allowing the foreign acquirer to earn interest income subject to little or (in some cases) no tax.[32]

CASE STUDIES

As part of our investigation, the Subcommittee reviewed two types of cross-border transactions. First, through a series of briefings, interrogatories, and document requests, the Subcommittee reviewed more than a dozen recent significant foreign acquisitions of U.S. companies. We selected the Canadian-based drugmaker Valeant Pharmaceuticals International—a successful, serial acquirer—as an illustrative case study. *See* Part I, *infra*. To better understand how Valeant's advantageous tax domicile has affected its expansion by acquisition, the Subcommittee focused on Valeant's three largest acquisitions to date: Medicis Pharmaceutical Corporation (2012); Bausch & Lomb Holding Incorporation (2013); and Salix Pharmaceuticals, Ltd. (2015). The information in these case studies is drawn from more than 1,800 pages of key deal-related documents produced voluntarily by Valeant at the Subcommittee's request, in addition to four rounds of detailed interrogatories and two staff interviews with Valeant executives.

Second, the Subcommittee also reviewed several "merger of equals" transactions in which a U.S. company combined with a foreign counterpart and chose to place the combined company's headquarters abroad. In this report, we describe the 2014 merger of Burger King Worldwide with Tim Hortons, Inc., which combined to form the Canada-based Restaurant Brands International (RBI). *See* Part II, *infra*. The information in the RBI case study is drawn from more than 500 pages of key deal-related documents produced voluntarily at the Subcommittee's request, in addition to two rounds of interrogatories and three staff interviews with RBI executives.

In addition to being reflective of broader trends, both the Valeant transactions and the Burger King transactions are economically significant. At the Subcommittee's request, the Joint Committee on Taxation used the Zephyr database published by Bureau van Dijk to compile a list of the top twenty OECD-based buyers of U.S. target companies by deal value over the past decade. Valeant ranks sixth. The ranking also puts the $11.4 billion value of the Burger King/Tim

[32] Current law provides certain rules and limitations associated with interest expense on intra-group and third party financing of domestic companies operating abroad (i.e., subpart F and foreign tax credit limitation) and on intra-group financing of foreign companies operating in the U.S. (i.e., section 163(j) deduction limitation).

Hortons merger in context; had the Bureau van Dijk classified it as an inbound acquisition, the transaction would have made the top-twenty list.

Top OECD-Based Buyers of US Targets by Value of Deals, 2006-2015			
Foreign Company Name	**Country**	**Deal Value ($B)**	**Number of Transactions**
ACTAVIS PLC	IE	95.4	3
MEDTRONIC HOLDINGS LTD	IE	60.7	1
ROCHE HOLDING AG	CH	60.4	12
INBEV SA	BE	52.0	1
TEVA PHARMACEUTICAL	IL	28.2	8
VALEANT PHARMACEUTICALS	CA	27.2	9
AERCAP IRELAND LTD	IE	26.4	1
SANOFI-AVENTIS SA	FR	25.2	4
LIBERTY GLOBAL PLC	GB	24.0	2
BASELL BV	NL	20.0	1
NEW MOON BV	NL	18.8	1
TORONTO-DOMINION BANK	CA	18.7	6
ASTRAZENECA PLC	GB	17.8	5
SUNTORY HOLDINGS LTD	JP	16.0	1
ZF FRIEDRICHSHAFEN AG	DE	13.5	1
ALCATEL SA	FR	13.4	1
NESTLE SA	CH	12.0	4
NATIONAL GRID PLC	GB	11.8	1
BANCO BILBAO VIZCAYA ARGENTARIA SA	ES	11.7	4
REYNOLDS GROUP HOLDINGS LTD	NZ	10.9	4

Source: Zephyr published by Bureau van Dijk and JCT Calculations.[33]

After reviewing the Valeant and Burger King transactions in Parts I and II of this report, we conclude in Part III with a brief description of one of the most famous inbound acquisitions in recent history—InBev's 2008 acquisition of Anheuser-Busch—with particular focus on the potential U.S. employment effects.

A preliminary note on tax terminology is in order. In the analysis that follows, we refer to *GAAP* effective tax rates, *non-GAAP* effective tax rates, and *cash-based* effective tax rates. For clarity, the GAAP effective tax rate is prepared

[33] The Joint Committee on Taxation used third-party data that prices deals slightly differently than the method used by Valeant, as described in Part I. As a result, Valeant's estimate of the total value of its U.S. acquisitions is higher than the estimate reflected in the table above.

on an accrual basis of accounting; it is the rate that is publicly disclosed in Securities and Exchange Commission filings. For management purposes, however, companies commonly maintain their tax rate on a non-GAAP basis or cash basis. A non-GAAP effective tax rate is an accrual-based tax calculation (similar to GAAP), but has typically been adjusted to exclude the tax effect of certain non-recurring items. It typically represents the accrual-based tax rate on management income. A cash-based effective tax rate reflects only cash taxes paid, including certain one-time tax benefits that are not typically reflected in GAAP-based reporting.

In analyzing the transactions we studied, we adopted the rate calculation used by the acquiring firm. For example, Valeant uses a cash-based effective tax rate for management purposes and in analyzing acquisitions. Accordingly, we primarily rely on cash rates in our discussion of the Valeant acquisitions, and where possible we have drawn comparisons to this cash-based rate. By contrast, Burger King Worldwide relied primarily on GAAP effective tax rates in its acquisition-related analysis. We followed suit in that case study.

I. Valeant Pharmaceuticals: Successful Foreign Acquirer

Valeant Pharmaceuticals International, Inc., is a Canadian-based multinational specialty pharmaceutical company. With $8.3 billion in revenues last year and market capitalization of more than $81 billion,[34] Valeant has seen remarkable growth since its predecessor firm was formed through the 1994 consolidation of four smaller pharmaceutical companies with $500 million in combined annual sales.[35] The company has operations across six continents, with activity in both developed and emerging markets. Its products include both over-the-counter and prescription drugs, with a focus in dermatology, eye health, neurology, gastrointestinal medicine, and consumer health care.[36] Among dozens of

[34] *Valeant Pharmaceuticals Reports Fourth Quarter And Full Year 2014 Financial Results*, VALEANT PHARMACEUTICALS INTERNATIONAL, INC. (Feb. 22, 2015), http://ir.valeant.com/investor-relations/news-releases/news-release-details/2015/Valeant-Pharmaceuticals-Reports-Fourth-Quarter-And-Full-Year-2014-Financial-Results/default.aspx.

[35] ICN Pharm., Inc., Annual Report (Form 10-K) (Dec. 21, 2001); *ICN Pharmaceuticals Merging With Affiliates*, N.Y. TIMES (Aug. 3, 1994), http://www.nytimes.com/1994/08/03/business/company-news-icn-pharmaceuticals-merging-with-affiliates.html. The combined corporation was renamed Valeant in 2003.

[36] *Description Valeant Pharmaceuticals International Inc.*, WALL ST. J., http://quotes.wsj.com/VRX/company-people (last visited July 28, 2015).

other medicines, Valeant's portfolio includes drugs such as Wellbutrin XL, used for the treatment of depression, and Ativan, used for the treatment of anxiety.[37]

Originally a U.S. corporation based in California,[38] Valeant merged with Canada's largest publicly traded drugmaker, Biovail Corporation, in 2010, with Biovail surviving as the parent. The Biovail deal was a merger-of-equals transaction, with Biovail (market cap. $2.6 billion) acquiring Valeant (market cap. $3.5 billion)[39] and the combined entity renamed Valeant Pharmaceuticals International.[40] The combined company moved its global headquarters to Ontario, Canada before relocating to Quebec in 2012.[41] After the acquisition, former Biovail shareholders owned 50.5% of the new firm, while former Valeant shareholders received 49.5%, along with an additional cash dividend.[42] The companies touted the merger as an opportunity to expand their presence in the U.S. and Canada and build on their core strengths in neurology, dermatology, and branded generic drugs.[43] Valeant CEO J. Michael Pearson also noted the collateral tax advantages of placing the combined company in Canada: "We had to do this sooner rather than later from a standpoint of gaining this tax rate."[44] Market analysts commented that the deal was "tax efficient, given that the corporate tax rate in Canada is between 10–15% compared with the 35% Valeant was expected to pay [in 2010]."[45] Through the merger, Valeant effectively stepped out of a tax regime with a 35% statutory rate

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[37] *Home » Operational Expertise » Valeant United States*, VALEANT PHARM. INT'L, INC., http://www.valeant.com/operational-expertise/valeant-united-states (last visited July 28, 2015).
[38] Valeant was known at the time as Valeant Pharmaceutical International.
[39] Phil Serafino, *Valeant, Canada's Biovail to Combine in Stock Deal*, BLOOMBERG BUS. (June 21, 2010), http://www.bloomberg.com/news/articles/2010-06-21/valeant-pharma-canada-s-biovail-corp-agree-to-merge-in-stock-transaction.
[40] Andy Georgiades, *Biovail Says Valeant Deal Rockets Company into the Future*, WALL ST. J. (June 21, 2010, 1:54 PM), http://www.wsj.com/articles/SB10001424052748704895204575320350568757726.
[41] Richard Blackwell, *Drug Giant Valeant Moving Global Head Office to Montreal Region*, GLOBE AND MAIL (Apr. 03, 2012, 10:53 AM), http://www.theglobeandmail.com/globe-investor/drug-giant-valeant-moving-global-head-office-to-montreal-region/article4097610/ (last modified Sept. 06, 2012, 12:59 PM).
[42] *Id.*; Pav Jordan and Esha Dey, *Drugmaker Biovail to Buy Valeant in $3.3 Billion Deal*, REUTERS (June 21, 2010, 5:03 PM), http://www.reuters.com/article/2010/06/21/us-biovail-valeant-idUSTRE65K1LA20100621.
[43] Andy Georgiades, *Biovail Says Valeant Deal Rockets Company into the Future*, WALL ST. JOURNAL (June 21, 2010, 1:54 PM), http://www.wsj.com/articles/SB10001424052748704895204575320350568757726.
[44] Pav Jordan & Esha Dey, *Drugmaker Biovail to buy Valeant in $3.3 billion deal*, REUTERS (June 21, 2010, 5:03 PM), http://www.reuters.com/article/2010/06/21/us-biovail-valeant-idUSTRE65K1LA20100621.
[45] SeekingAlpha, *A Closer Look at the Biovail – Valeant Merger*, NASDAQ (June 23, 2010, 3:34:39 AM). http://www.nasdaq.com/article/a-closer-look-at-the-biovail-valeant-merger-cm26039#ixzz3gY9bopYq.

and worldwide system of taxation with deferral and opted into a tax regime with a 27% statutory rate and territorial system of taxation.[46]

Since the merger, Valeant has achieved single-digit cash effective tax rates on both its U.S. and worldwide income. Its GAAP effective tax rate has varied widely due in part to its acquisition activity, but it appears to have reached a steady rate in the mid-teens.[47] Valeant uses a cash-based effective tax rate for management purposes and in analyzing acquisitions. Accordingly, we primarily rely on cash rates, and where possible, we have drawn comparisons to this cash-based rate.

Valeant –Tax Rates[48]							
	2010	2011	2012	2013	2014	2015	2016
Worldwide cash effective tax rate	5.9%	4.5%	2.8%	3.1%	3.3%	3.3%	3.9%
U.S. cash effective tax rate	0%	0.6%	0.6%	0%	0.8%	177%[49]	10.1%
Worldwide GAAP effective tax rate	11.9%	986%[50]	70.6%	34.3%	16.5%	17.4%	14.6%
U.S. GAAP effective tax rate	-10.5%	48%[51]	34.6%	27.4%	4.4%	—	—

[46] *See* PRICEWATERHOUSECOOPERS, TAX FACTS AND FIGURES: CANADA 2011 (2011), *available at* https://www.pwc.com/ca/en/tax/publications/tax-facts-figures-2011-en.pdf.
[47] In general, Valeant's cash tax rate is lower than its GAAP rate because certain tax benefits that cannot be recognized in the rate for GAAP accounting purposes can be recognized in the cash-based rate. In general, these include (but are not limited to) the benefit of acquired net operating losses, acquired tax credits, and certain benefits related to stock option deductions.
[48] Valeant's U.S. GAAP effective tax rate was 27.4% in 2013 and 4.4% in 2014. Letter from Valeant to PSI (July 7, 2015), 6 ("Valeant Resp. II"). Valeant's worldwide GAAP effective tax rate was 34.3% in 2013 and 16.5% in 2014, and it is projected to be 17.4% in 2015 and 14.6% in 2016. Letter from Valeant to PSI (June 10, 2015), 4 ("Valeant Resp. I"). As explained above, the Majority Staff has focused on cash effective tax rates.
[49] Valeant's U.S. cash tax rate spiked in 2015 due to "the timing of items with respect to which the company previously recorded a deferred tax liability for future book expenses that are not deductible for federal tax purposes." Valeant Resp. II, 5.
[50] Valeant's 2011 worldwide GAAP effective tax rate spiked due to the jurisdictional mix of where Valeant earned its profits and losses. Due to the fact that the company does not record benefits for all its tax losses for U.S. GAAP purposes, the large losses generated in jurisdictions such as Canada contributed to a lowered denominator, and thus resulted in a higher GAAP effective tax rate.
[51] Valeant's U.S. GAAP effective tax rate spike in 2011 was due to the jurisdictional mix of where Valeant earned its profits and losses. Valeant Resp. II, 5. "[L]arge losses in jurisdictions including Canada reduced its operating income, thus resulting in a higher effective rate." *Id.*

Howard Schiller, Valeant's Chief Financial Officer from 2011 through June 2015, told the Subcommittee that Valeant's low tax rate, made possible by the merger with Biovail, has "turbocharged" Valeant's expansion by acquisition.[52] Indeed, Valeant has experienced a recent period of rapid growth, fueled largely by the acquisition of U.S. businesses. Since 2010, Valeant has completed acquisitions with a total value of approximately $36 billion, including $30 billion in acquisitions of U.S. corporations.[53] As noted above, Valeant is now the sixth-largest foreign acquirer of U.S. companies in terms of deal value.[54] *Forbes* summarized the thinking of many market observers: "When it comes to value-oriented stock investors, many are looking for the Valeant Pharmaceuticals in every sector: serial dealmakers that use tax advantages to consolidate entire industries, wrenching out billions in synergies, transforming from also-rans into global powerhouses."[55]

Valeant considers many factors in evaluating and pricing a potential acquisition, but two key metrics predominate.[56] First, Valeant looks to the "projected internal rate of return to understand the overall magnitude of the capital allocation opportunity."[57] Valeant also considers an acquisition's "payback period"—the projected time period it will take to fully recover Valeant's investment—"to understand speed of return and forecast risk."[58] To determine whether a new acquisition is worth the contemplated acquisition price, Valeant generally seeks deals projected to achieve a 20% internal rate of return and a payback period of 6 years or less.[59] In his written testimony to the Subcommittee,

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[52] Subcommittee Interview with Schiller (July 24, 2015). Schiller elaborated: "I think the clear answer is that what really distinguishes Valeant is its ability to create value [through its business model]. . . . But its tax rate has augmented its growth. There is no question that we would not be in the same place we are in today if we had a higher tax rate. We have been able to plow that [after-tax profit] back in at a very high rate of return." *Id.*

[53] Data gathered from publicly available Valeant announcements. *See* Valeant Pharmaceuticals Investor Relations News Releases: http://ir.valeant.com/investor-relations/news-releases/2014/default.aspx.

[54] *See* Table 1, *supra.*

[55] Antoine Gara, *Could Avago Become the Valeant Pharmaceuticals of the Semiconductor Sector?*, FORBES (May 28, 2015, 2:24PM), http://www.forbes.com/sites/antoinegara/2015/05/28/could-avago-become-the-valeant-pharmaceuticals-of-the-semiconductor-sector/.

[56] Subcommittee Interview with Howard Schiller, *supra* note 1.

[57] Valeant Resp. II, 3.

[58] Valeant Resp. II, 3.

[59] Written Statement of Howard Schiller, Corporate Dir., Valeant Pharm. Int'l, Inc. (July 24, 2015); Briefing with Howard Schiller & Jeremy Lipshy, Corporate Dir. & Dir. of Int'l Tax Planning, Valeant Pharm. Int'l, Inc. (April 10, 2015). Mr. Schiller later noted that, when seeking to acquire large public

Mr. Schiller described Valeant's strategy as a "financially disciplined approach" and explained that Valeant's "financial guidelines have allowed us to stay disciplined in our acquisition strategy, and we are proud that—while not every acquisition has paid off—overall our strategy has succeeded, and on the whole we have surpassed these financial targets."[60] As a result, the "majority of [Valeant's] transactions are delivering above our targeted 20 percent internal rate of return."[61]

In each of the acquisitions reviewed by the Subcommittee, Valeant relied on the ability to achieve lower tax rates in order to meet those key goals. Valeant's primary valuation of target companies is based on an assumed tax rate of 36%. In the transactions we reviewed, however, Valeant performed a pre-acquisition tax analysis to determine the potential effective tax rate that could be achieved by integrating the target into its worldwide corporate group headquartered in Canada. Applying that new, lower tax rate to the target company's future cash flow, Valeant evaluated key deal metrics, including internal rate of return and payback period. In each case reviewed by the Subcommittee, Valeant's ability to hit or approximate the targets of 20% return and 6-year payback period appears to have largely depended on its ability to lower the target company's effective tax rate.

A. The Medicis Acquisition

Valeant's first major purchase after the Biovail merger was its December 2012 acquisition of Medicis, a pharmaceutical company headquartered in Scottsdale, Arizona. Valeant paid $2.6 billion (or $44 per share) in an all-cash deal. The $44 price per share paid by Valeant represented a 39% premium on Medicis's closing share price before the acquisition was announced. Valeant explained the acquisition primarily as a means of expanding its reach and offerings in dermatology.[62]

Valeant and its target had dramatically different tax profiles. Before the acquisition, Medicis had a U.S. cash effective tax rate of 30.3% in 2010 and 25% in

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companies, Valeant does not always expect 20% return. *See* Subcommittee Interview with Howard Schiller, *supra* note 1.

[60] Written Statement of Howard Schiller, Corporate Dir., Valeant Pharm. Int'l, Inc. (July 24, 2015).

[61] *Id.*

[62] *See Valeant Pharmaceuticals International, Inc. Agrees to Acquire Medicis Pharmaceutical Corporation for $44.00 Per Share in Cash,* VALEANT PHARM. INT'L, INC. (Sept. 03, 2012), http://ir.valeant.com/investor-relations/news-releases/news-release-details/2012/Valeant-Pharmaceuticals-International-Inc-Agrees-To-Acquire-Medicis-Pharmaceutical-Corporation-For-4400-Per-Share-In-Cash1130/default.aspx.

2011.[63] Medicis had no significant non-U.S. income. By contrast, Valeant had a U.S. cash effective tax rate of 0% and 0.6% in 2010 and 2011, respectively, and a worldwide cash effective tax rate of 5.9% and 4.5% in 2010 and 2011, respectively.[64]

As part of its due diligence, Valeant reviewed Medicis's recent tax returns and determined that it was possible to reduce Medicis's effective tax rate by integrating the company into Valeant's worldwide corporate group. In an August 2013 presentation to the Valeant board, Valeant executives forecasted that it would be possible to achieve a "20% effective tax rate post acquisition" on legacy Medicis profits.[65] Using a preliminary model, Valeant compared the economics of the Medicis acquisition using two potential tax rates: 36%, the applicable statutory federal and state corporate tax rate; and 20%, the worldwide cash tax rate Valeant thought it could achieve through post-acquisition tax planning.[66] Not surprisingly, the analysis showed that the tax advantages available to Valeant made the Medicis acquisition significantly more attractive along key deal metrics.

Medicis Acquisition Base Case Projections (at $44/share)				
	Valeant Goal	36% Tax Rate	20% Tax Rate	*Tax Differential*[67]
Net Present Value of Deal Gains	—	$981 million	$1.721 billion	*$740 million*
Internal Rate of Return	20%	14%	17%	*3%*
Payback Period	6 years	9.1 years	7.2 years	*1.9 years*

As the table above illustrates, Valeant projected that it could significantly enhance its return on the Medicis acquisition by integrating it into a corporate group based in Canada. When evaluated at a tax rate close to the U.S. statutory rate, the net present value of the Medicis deal gains (at the ultimate acquisition price of $44/share) was $981 million.[68] That value increased by 75% (or $740

[63] Valeant Resp. I, 3.
[64] Valeant Resp. I, 4.
[65] App. 51 (VRXPSI-01-0087).
[66] App. 52-53 (VRXPSI-01-000092-93).
[67] It is important to note that what we term the "tax differential" derives both from anticipated tax savings and expected return on reinvestment of those savings in Valeant's business.
[68] Specifically, as calculated by Valeant, deal gains is the difference between the "synergized" net present value of the target—that is, the value of the target after accounting for profit-boosting reforms planned by Valeant—and the cost of the deal—that is, the aggregate purchase price of the

million) to $1.72 billion when viewed through the lens of a foreign acquirer capable of reducing the target company's cash effective tax rate to 20%. Similarly, the internal rate of return on the Medicis acquisition rose from 14% to 17% when Valeant's tax planning advantages were accounted for. And Valeant determined that its investment in Medicis would pay for itself faster—within 7.2 years rather than 9.1 years—at a 20% tax rate.

Significantly, the only scenario that met or exceeded both of Valeant's key targets—a 20% internal rate of return and 6-year payback period—was the company's "upside" scenario at the projected lower tax rate, as displayed in the table below.[69] With the benefit of a 20% tax rate, Valeant projected the deal would yield an impressive 23% internal rate of return and would pay for itself in 5 years.[70] Without those tax benefits, the deal missed the mark.

Medicis Acquisition Upside Case Projections (at $44/share)				
	Valeant Goal	36% Tax Rate	20% Tax Rate	*Tax Differential*
Net Present Value of Deal Gains	—	$2.28 billion	$3.364 billion	*$1.06 billion*
Internal Rate of Return	20%	19%	23%	*5%*
Payback Period	6 years	6.2 years	5 years	*1.2 years*

Valeant "anticipated that its effort to integrate [Medicis into Valeant] would yield significant savings," but it did not specifically quantify the savings.[71] Post-acquisition tax savings, however, can be approximated based on Valeant's projection of the achievable effective tax rate for Medicis done as part of the deal analysis. Assuming a cash effective tax rate of 20% post-acquisition compared to a 36% rate,

target. "In other words, it represents the excess of the company's estimate of the synergized value of the business being acquired over the amount expected to be paid to acquire that business." Letter from Valeant to PSI (July 21), 3 ("Valeant Resp. III"). Valeant states that it does not rely on NPV when evaluating potential acquisition transactions, but that figure features very prominently in its Board presentations alongside what the company describes as key deal metrics. *See* App. 50, 52, 53 (VRXPSI-01-0000081, 92, 93); *see also* App. 62, 65 (VRXPSI-01-0000613, 624).

[69] App. 53 (VRXPSI-01-000093).

[70] *See* App. 52-53 (VRXPSI-01-000092-93).

[71] Valeant Resp. I, 9.

the acquisition by Valeant could yield approximately $680 million in tax savings over 10 years.[72]

1. Intellectual Property Transfers

Before the acquisition, all of Medicis's intellectual property was held in the United States, and all royalties were earned in the United States.[73] Within four months of the acquisition, Valeant transferred Medicis's intellectual property portfolio to low-tax foreign jurisdictions, with the exception of products that Valeant had sold or discontinued.[74] It achieved this through a multi-step process. To simplify, the newly acquired Medicis granted Valeant-Canada[75] a license to all its intellectual property. Valeant-Canada sub-licensed that newly transferred Medicis intellectual property to other entities, ultimately consolidating the rights to Medicis's patents in Valeant's Irish subsidiary (Valeant Holdings Ireland or VHI) and (for a short time) Valeant's U.S. group.[76]

The object of these intellectual property transfers was to shift abroad the upside of any future appreciation in the value of Medicis's property. To understand why, it is important to note that transferring intellectual property outside the country does have a cost. Under section 482 of the tax code, Valeant's foreign affiliates were required to compensate Valeant's U.S. group for the intellectual property transfer at an arms-length rate—which results in taxable income in the United States. To simplify, that transaction must be priced to reflect the value of the intellectual property at the time of the transfer. But as a consequence, if the transferred intellectual property later appreciates in value, the *accretion* will be taxed at the lower foreign rate. If the intellectual property unexpectedly depreciates, the guarantee royalty payment mandated by section 482 will cause a loss.

Here, Valeant essentially placed a bet that transferring Medicis's intellectual property overseas would be worth the upfront tax cost. To comply with section 482,

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[72] This estimate assumes a 10-year operating income of $4.26 billion from 2013 through 2022 based on Medicis's projected income in 2013, 2014, and 2015, and further assuming that its income held steady from 2015 to 2022. *See* App. 85 (VRXPSI-02-000086). Medicis's analyst-projected future tax rate was 39.5%. *Id.*

[73] Valeant Resp. II, 3.

[74] "[T]wo legacy Medicis products were sold to unrelated parties in separate transactions, and five legacy Medicis products were discontinued or abandoned." Valeant Resp. II, 8.

[75] Where necessary for clarity, we refer to the Canadian parent company, Valeant Pharmaceuticals International, Inc., as "Valeant-Canada."

[76] *See* Valeant Resp. I, 6.

when Valeant transferred Medicis's intellectual property abroad, it set up tiered royalties payments (at rates between 20% to 35% depending on the level of net sales for each product) that Valeant's non-U.S. affiliates must pay to Valeant's U.S. group in exchange for the transfer; those payments are taxable in the United States.[77] Since 2013, Valeant's non-U.S. affiliates have paid $156 million in U.S.-taxable Medicis royalties to the U.S. group.[78]

But Valeant concluded that it was worth the price. Valeant's pre-acquisition Board presentation predicted that additional taxes on Valeant's transfer of Medicis intellectual property would be offset by the fact that "[i]ncreased profits attributable to synergies will be taxed at less than 4%."[79] Through the intellectual property transfers, Valeant ensured that (except for the tiered royalties described above) future income derived from Medicis's intellectual property would be earned by entities outside the United States. In the first full year following the acquisition, while it *received* the inbound royalty payments described above, Valeant's U.S. group also *paid* significant royalties to Valeant Pharmaceuticals Luxembourg (VPL) and Valeant-Canada for use of transferred Medicis intellectual property.[80] Those outbound royalty payments are then taxed at the lower Canadian or Luxembourg rates.

After the 2013 Bausch & Lomb acquisition, however, those outbound payments ceased because Valeant further restructured its intellectual property portfolio. As described in greater detail below (*see* I.B.1 *infra*), in 2013, Valeant consolidated much of its worldwide intellectual property in a single principal company—Valeant Holdings Ireland—and converted its U.S. entities into essentially limited-risk distributors and contract manufacturers.[81] Under that arrangement, VHI contracts with Valeant affiliates (including some U.S. entities) to manufacture Medicis products. A member of Valeant's U.S. group, VPNA, then buys the finished product from VHI and handles product sales, marketing and distribution in the U.S.[82] As a result, apart from the return on those services and the tiered royalties required under section 482, Valeant's Irish subsidiary now

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[77] Valeant Resp. II, 7.
[78] Valeant Resp. I, 15, 9-D2.
[79] App. 54 (VRXPSI-01-0000104).
[80] Valeant Resp. I, 14. In the first two full years following the acquisition, Valeant-U.S. received related-party royalties of $22.9 million in 2013 and $63 million in 2014 in combined royalties from the non-U.S. Valeant corporate group.
[81] Valeant Resp. II, 8.
[82] VPNA operates under a buy-sell arrangement pursuant to which it purchases inventory and earns a return on its sales, marketing and distribution activities.

earns substantially all the income on worldwide sales of Medicis products; Valeant's U.S. group shares in part of those profits through its equity interest in VHI.

2. Intercompany Debt

In its Board presentation, Valeant forecasted that it would use acquisition debt to "further erode [Medicis's] tax base."[83] Accordingly, "[i]n connection with the Medicis acquisition, VPI Delaware [a Valeant subsidiary] issued an aggregate $2.75 billion in debt financing to support the acquisition by VPI Delaware of Medicis."[84] Since the acquisition, VPI has made significant deductible interest payments to third party lenders—thereby reducing the U.S. group's tax base. The Medicis acquisition debt was not issued by the Valeant-Canada parent, and consequently it has not resulted in significant outbound interest payments to low-tax jurisdictions. Valeant's non-U.S. affiliates did, however, guarantee the Medicis acquisition debt. As a result Valeant's U.S. group makes significant outbound guarantee fee payments. In 2013 and 2014, Valeant's U.S. group made $19.5 million in guarantee fee payments to non-U.S. related parties in connection with the Medicis acquisition debt, and those payments will continue for the life of the corresponding loans.[85] The outbound guarantee fees are deductible for U.S. federal tax purposes.[86]

B. The Bausch & Lomb Acquisition

On August 5, 2013, Valeant acquired Bausch & Lomb, one of the world's largest producers of eye health products. The acquisition was completed for $8.7 billion in cash, with $4.5 billion paid to the target's owner, the private equity firm Warburg Pincus, and the remaining $4.2 billion used to pay down the target's outstanding debt. Headquartered in Rochester, New York,[87] Bausch & Lomb initially filed to go public before Valeant acquired it, reporting $3.03 billion in annual sales in 2012.[88] By further expanding Valeant's ophthalmology offerings and facilitating an expansion into China, Valeant anticipated the acquisition would

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[83] App. 54 (VRXPSI-01-0000104).
[84] Valeant Resp. I, 19.
[85] Valeant Resp. II, 12-13, Table 8-D1.
[86] Valeant Resp. II, 3. Likewise, inbound guarantee fees are includible in income for U.S. federal tax purposes.
[87] *Worldwide Locations*, BAUSCH + LOMB, http://www.bausch.com/our-company/worldwide-locations#.VZF11qPD_5I (last visited July 24, 2015).
[88] WP Prism Inc., Registration Statement (Form S-1) (Mar. 22, 2013), *available at* http://www.sec.gov/Archives/edgar/data/1416436/000119312513122167/d502777ds1.htm#rom502777_8.

create a "global eye health platform with estimated pro forma 2013 net revenue of more than $3.5 billion."[89]

Prior to the acquisition, Bausch & Lomb boasted a significant international presence, the company had manufacturing in nine countries and sales in more than 100.[90] In 2012, more than 60% of its revenue was from outside the United States, and the company's growth plans contemplated expansion in new markets, including Argentina, India, and Japan.[91] At the time of the acquisition, Bausch & Lomb had $187 million in unrepatriated overseas earnings.[92] With a projected 32% worldwide effective tax rate at the time of the acquisition, Bausch & Lomb's future tax burden stood in sharp contrast to Valeant's single-digit worldwide rate and ability to repatriate international earnings without additional taxes.[93]

In evaluating the acquisition, Valeant again analyzed the extent to which it could reduce rates on Bausch & Lomb's worldwide income by integrating the company into Valeant's Canada-based corporate group.[94] In a May 2013 presentation to the company's Board, Valeant executives presented the results of that analysis. Valeant compared the economics of the Bausch & Lomb acquisition using two potential tax rates: 36% (close to Bausch & Lomb's projected steady-state rate) and 20% (the worldwide cash tax rate Valeant believed it could achieve post-acquisition). Again the analysis showed that the tax advantages available to Valeant would make the Bausch & Lomb acquisition significantly more attractive along several key deal metrics.

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[89] Valeant Pharm. Int'l, Inc. & Bausch & Lomb, *Press Release: Valeant Pharmaceuticals International, Inc., To Acquire Bausch & Lomb for $8.7 Billion*, SEC.GOV (May 27, 2013), http://www.sec.gov/Archives/edgar/data/885590/000119312513242429/d546764dex991.htm; *see also* Richard Blackwell, Sean Silcoff, & Bertrand Marotte, *Valeant Pharmaceuticals Eyes China with Bausch & Lomb Deal*, HSBC GLOBAL CONNECTIONS (Aug. 8, 2013), https://globalconnections.hsbc.com/canada/en/articles/valeant-pharmaceuticals-eyes-china-bausch-lomb-deal.

[90] App. 58 (VRXPSI-01-0000311).

[91] App. 70 (VRX-PSI-01-0000666).

[92] Valeant maintained a deferred tax liability on these earnings for financial accounting purposes.

[93] Before the acquisition, Bausch & Lomb had a U.S. cash effective tax rate of 2.8% and -1.6% in 2011 and 2012, respectively, and a worldwide cash effective tax rate of 1062.9% and 471.4% in 2011 and 2012, respectively. Those unusual tax rates were due to the company's significant losses in the United States and significant tax liability outside the United States. Valeant Resp. II, 5-6. Bausch & Lomb projected, however, that its non-GAAP effective tax rate would stabilize to approximately 32% in 2013-2014. App. 71 (VRXPSI-01-0000693); *see* App. 63 (VRX-PSI-01-0000614).

[94] App. 64, 65 (VRXPSI-01-0000618, 624).

Bausch + Lomb Acquisition Valeant's Base Case Projections (at $8.5B purchase price)			
	36% Tax Rate	20% Tax Rate	*Tax Differential*
Net Present Value of Deal Gains	$1.6 billion	$4 billion	*$2.4 billion*
Internal Rate of Return	12%	15%	*3%*
Payback period	9.7 years	8 years	*1.7 years*

The table above illustrates how Valeant believed it could enhance the economics of the Bausch & Lomb acquisition by integrating it into a corporate group with a lower tax rate. Although neither tax-rate scenario hit Valeant's targets of a 20% internal rate of return and 6 year payback period, the low-tax scenario came much closer. When evaluated at a tax rate close to the U.S. statutory rate, the net present value of the deal gains was $1.6 billion.[95] But that value jumped by $2.4 billion (or 28% of the acquisition price) when viewed through the lens of a foreign acquirer capable of reducing the target company's cash effective tax rate to 20%. Similarly, the internal rate of return on the Bausch & Lomb acquisition rose from 12% to 15% when the tax advantages of having a Canadian parent were accounted for. And Valeant determined that its investment in Bausch & Lomb would pay for itself in a shorter time period—8 years rather than 9.7 years—at a 20% tax rate.

In financial models prepared prior to the acquisition and reviewed by the Subcommittee, Valeant analyzed available tax planning in greater detail.[96] The company ran three alternative tax planning scenarios through its proprietary model. The most tax-efficient scenario was labeled "Alt 6." The Alt 6 scenario contemplated a transfer of all intellectual property to Valeant Holdings Ireland through a guaranteed license, as well as a "push down" of $3.5 billion in debt to Valeant's U.S. group. Valeant projected that the Alt 6 strategy would reduce Bausch & Lomb's average cash effective tax rate to 17.1% through 2023 and achieve a cash effective tax rate of 9.9% for the combined entity. Valeant projected that the "status quo" for Bausch & Lomb would result in a 10-year tax bill of $5.13 billion, while integration into Valeant would reduce that tax bill to $2.99 billion—for a tax savings of $2.13 billion. Those projected tax savings rise to $3.6 billion when

[95] App. 65 (VRXSI-01-0000624).
[96] This information is drawn from Valeant's financial models. The Majority Staff has not included those models in the Appendix.

deductions attributable to Valeant's intercompany acquisition debt are accounted for.[97]

Valeant does not track whether it is on pace to achieve its projected tax savings "because the projections did not take into account all possible effects, and because the company does not track what its taxable income might have been had it not integrated the two businesses."[98] Based on data available, however, Valeant's tax planning appears to have had a significant effect on Bausch & Lomb's tax profile. The target company was integrated into a corporate group with a U.S. cash effective tax rate of 0.8% and worldwide cash effective tax rate of 3.3% in the first year following the acquisition. Post-acquisition tax rates for Bausch & Lomb are not available because the target company was entirely integrated into Valeant rather than transformed into a subsidiary. The effect of Valeant's integration of Bausch & Lomb, however, is reflected to some extent by a comparison of Bausch & Lomb's projected non-GAAP tax rate of 32% (2013 and 2014) with Valeant's post-acquisition cash tax rates. Valeant's U.S. cash effective tax rate remained under 1% in the first full year following the acquisition, and its worldwide cash effective tax rate ticked up from 3.1% to 3.3%.[99]

1. Intellectual Property Transfers

Before the acquisition, approximately 75% of Bausch & Lomb's intellectual property was located in the United States.[100] Within five months of the acquisition, Valeant moved Bausch & Lomb's entire intellectual property portfolio to Ireland. It achieved this through a multi-step process. *First*, Valeant transferred and consolidated its ownership interests in VPL, Bausch & Lomb S.a.r.l. (a Luxembourg subsidiary), and certain other non-U.S. entities into its Irish subsidiary VHI. *Second*, Valeant's U.S. entities (including Bausch & Lomb U.S.) granted two U.S. Valeant holding companies a fully paid-up exclusive license to their entire intellectual property portfolio, in exchange for shares in the holding companies. *Third*, the two Valeant U.S. holding companies, in turn, granted VHI a fully paid-up exclusive license to their intellectual property, in exchange for equity in VHI. Because that equity in VHI served as compensation for the transfer of intellectual

[97] This information is drawn from Valeant's financial models. The Majority Staff has not included those models in the Appendix.
[98] Valeant Resp. I, 9.
[99] Valeant Resp. I, 4. Valeant stated that it has no specific plans to access Bausch & Lomb's $187 million in accumulated earnings. *See* Valeant Resp. I, 9; III, 4.
[100] Valeant Resp. III.

property to a related party, Valeant was required under section 482 of the tax code to ensure the interest corresponded to the arms-length value of the transferred intellectual property at the time of the sale. Going forward, Valeant's U.S. holding companies receive a share of worldwide income earned by VHI, and that income is taxable in the United States.[101]

As in the case of Medicis, the practical result of these transfers is that all income on non-U.S. sales of Bausch & Lomb products is earned outside the U.S. tax "net," except for the U.S. share of VHI income. In addition, the income from U.S. sales of Bausch & Lomb products is now limited to the routine return on product sales, marketing, and distribution in the U.S. and manufacturing (to the extent it is performed in the U.S.), plus the U.S. share of VHI income. Bausch & Lomb's U.S. entities now function essentially as a "contract manufacturer, providing manufacturing services to other members of the Valeant group."[102] VPNA (a U.S. Valeant subsidiary) serves as a limited-risk distributor which purchases finished product from other members of the Valeant group for distribution in the United States.[103] Consequently, all income generated by Bausch & Lomb's intellectual property is sourced and taxed abroad, with the exception of the U.S. shares of VHI income described above and the fees for contract manufacturing and distribution functions.

It is important to note that Valeant Holdings Ireland is now the company's principal "risk taker" with respect to intellectual property. VHI bears the risks and costs associated with the ongoing development and exploitation of the licensed Medicis and Bausch & Lomb intellectual property. But VHI also will earn the rewards. If Valeant is successful in its plans to enhance the profitability of Medicis and Bausch & Lomb's intellectual property, the lion's share of those increased or "synergized" profits will flow to VHI.

2. Intercompany Debt

In connection with the Bausch & Lomb acquisition, Valeant pushed down $2.4 billion of the acquisition debt from its foreign affiliates to a Delaware subsidiary (VPI-Delaware), thereby creating a stream of deductible interest

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[101] Valeant Resp. I, 8-9; Valeant Resp. II, 7-8.
[102] Valeant Resp. II, 8-9.
[103] Valeant Resp. II, 9. As part of this restructuring, "the licenses of intellectual property by other members of the Valeant group to VPNA were cancelled. VPNA ceased being a licensee of intellectual property and thus stopped paying royalties to other members of the Valeant group." Valeant Resp. II, 8.

payments that have significantly reduced Bausch & Lomb's U.S. tax base. Specifically, Valeant-Canada issued an aggregate $7.3 billion in debt financing from third-party banks. Valeant-Canada then made an interest-free loan of $3.1 billion to a Luxembourg subsidiary, Biovail International S.a.r.l., which in turn made an interest-bearing loan (at 6%) of $2.4 billion to VPI-Delaware.[104]

The result of this intercompany lending is evident in the rise in Valeant-U.S.'s tax-deductible, outbound related-party interest payments. In the two years preceding the Bausch & Lomb acquisition, Valeant's U.S. group made an average of $219,000 per quarter in related-party interest payments. In the first full year following the acquisition, those payments swelled to $59.9 million per quarter—a 273-fold increase.[105] To date, Valeant's U.S. group has made $320.2 million in interest payments on the Bausch & Lomb acquisition debt to Biovail International S.a.r.l. and projects another $375 million in interest payments through the first quarter of 2017; those payments will continue through the life of the loan.[106] The interest payments are fully deductible in the U.S. and subject to no U.S. federal withholding taxes.[107] Only a portion of the interest income received by Valeant in Luxembourg is taxable—at single-digit tax rates.

C. The Salix Acquisition

Founded in 1989, Salix Pharmaceuticals was a North Carolina-based pharmaceutical company specializing in gastrointestinal health. In 2013, the company had $933.8 million in revenues[108] and a market capitalization of more than $5.47 billion.[109] With an effective tax rate hovering in the high 30s to low 40s,

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[104] Valeant Resp. I, 21.
[105] *See* Valeant Resp. I, 12-13.
[106] *See* Valeant Resp. II, 11-12. Those outbound interest payments were offset to a minor degree by inbound guarantee fees. Because one of Valeant's U.S. entities was one of several guarantors of the Bausch & Lomb and Salix acquisition debt, Valeant's Canadian parent paid guarantee fees to VPI-Delaware from 2012 through 2014 totaling $22.5 million. Those payments increased Valeant's taxable income in the United States. *See* Valeant Resp. II, 11.
[107] Valeant notes that "some deductions were limited pursuant to section 163(j)," but as of December 31, 2014, those previously limited deductions have been allowed. Valeant Resp. III, 3.
[108] Salix Pharm., Annual Report (Form 10-K) (Feb. 28, 2014), *available at* http://www.salix.com/assets/pdf/investors/2013_10K.pdf?id=790422.
[109] *See Id.*; *Salix Pharmaceuticals Ltd. (SLXP)*, YAHOO FINANCE, http://finance.yahoo.com/q/hp?s=SLXP&a =11&b=30&c=2013&d=00&e=2&f=2014&g=d (last visited July 28, 2015) (calculated using stock price from Yahoo Finance on Dec. 31, 2013 and outstanding shares as indicated in Salix 10-K).

however, the company actively sought opportunities to relocate to a lower-tax jurisdiction.[110]

On July 9, 2014, Salix announced that it had agreed to buy an Irish subsidiary of the Italian-based pharmaceutical firm Cosmo Pharmaceuticals SpA for $2.7 billion in stock. The planned deal was to be structured as an inversion, placing the combined company's headquarters in Ireland.[111] If the transaction were approved, Salix shareholders would own slightly less than 80% of the new firm; that ownership percentage shielded the deal from one of the anti-inversion provisions contained in section 7874 of the tax code, which treats inverted corporations as domestic corporations when shareholders of the U.S. company own 80% or more of the new entity.[112] Salix Chief Executive Officer Carolyn Logan specifically noted that the deal would "greatly enhance" the company's ability to compete for new acquisitions.[113]

On September 22, 2014, the U.S. Treasury Department issued new guidance designed to tighten anti-inversion rules. The guidance applied to inversions in which a U.S. company's shareholders would own more than 60% or more of the combined company, as legacy Salix shareholders would have.[114] On October 3, 2014, citing a "changed political environment [that] has created more uncertainty regarding the potential benefits [Salix] expected to achieve" through the Cosmo deal, Salix announced that it had decided to terminate the proposed transaction.[115]

Valeant and other interested acquirers then stepped in. Within months, in February 2015, Valeant announced that it had agreed to acquire Salix for $158 per share. The companies later revised the terms to $173 per share, for a total enterprise value of approximately $15.8 billion. The acquisition price represented a

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[110] Salix's 2013 U.S. GAAP effective tax rate was 31.9%; its 2012 U.S. cash effective tax rate was 41.6%. Valeant Resp. I, 10.
[111] Simeon Bennett & Alex Wayne, *Salix to Merge with Cosmo in Latest Tax Inversion Deal*, BLOOMBERGBUSINESS (July 9, 2014, 4:13 PM), http://www.bloomberg.com/news/articles/2014-07-08/salix-to-merge-with-cosmo-in-latest-tax-inversion-deal.
[112] See 26 U.S.*C.* § 7874 (2012).
[113] Bennett & Wayne, *supra* note 111.
[114] Treasury Notice 2014-52.
[115] Chip Cummins, *Salix, Cosmo Cancel Merger Agreement*, WALL ST. J. (Oct. 3, 2014, 4:22 AM), http://www.wsj.com/articles/salix-cosmo-cancel-merger-agreement-1412319533.

greater than 40% premium over Salix's share price before the acquisition was announced.[116]

The tax profiles of Salix and Valeant differed sharply. Before the acquisition, Salix projected that its U.S. cash effective tax rate would level out at 38% in 2017 and beyond;[117] market analysts similarly expected Salix's future effective tax rate to hover in the "mid/high 30% range."[118] By contrast, Valeant had a U.S. cash effective tax rate of 0% and 0.8% in 2013 and 2014, respectively, and a worldwide cash effective tax rate of 3.1% and 3.3% in 2013 and 2014, respectively.

Salix Acquisition Valeant's Base Case Projections (at $160/share)[119]				
	36% Tax Rate	10% Tax Rate	5% Tax Rate	Tax Differential
Internal Rate of Return	15.6%	21.4%	22.4%	up to 6.8%

Valeant again evaluated the deal in light of potential tax savings. It assumed the applicable 36% statutory rate applied to the Salix acquisition. But because Valeant was uncertain precisely what rate it could achieve post-acquisition, it evaluated the deal based on two possible achievable tax rates, 5% and 10%. As the table above illustrates, Valeant projected that it could significantly enhance the economics of the Salix acquisition by drawing on its non-U.S. tax profile. Once again, Valeant projected that the only way to hit its goal of 20% internal rate of return was by reducing the target's tax rate through integrating it into a Canada-based corporate group. Assuming a share price of $160, Valeant projected that its internal rate of return would be 15.6% at a 36% tax rate, which would jump to a 22.4% return at a 5% tax rate.

Valeant estimated that the "aggregate tax savings" from its post-acquisition tax planning "would be approximately $562 million over five years" in nominal

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[116] David Crow & James Fontanella-Khan, *Raised Offer from Valeant Knocks Endo out of Salix Race*, FIN. TIMES (March 16, 2015, 6:29 PM), http://www.ft.com/intl/cms/s/0/f8c8bf1c-cbdd-11e4-beca-00144feab7de.html#axzz3gvVXLsaKaxzz3hCYKiRZZ.
[117] App. 76 (VRXPSI-01-0001047).
[118] App. 73 (VRXPSI-01-0000867).
[119] Valeant evaluated the acquisition as a purchase price ranging from $140 per share to $160 per share. *See* App. 80, 81 (VRXPSI-01-0001112, 1113). The final purchase price was $173 per share. Valeant considered the rate of return under two base cases; the table above reflects the upside case ("Base Case 1").

dollars.[120] The immediate tools for achieving those savings entailed the transfer of intellectual property outside the U.S. tax net and the use of intercompany lending.

1. Intellectual Property Transfers

Prior to the acquisition, all but an insignificant portion of Salix's intellectual property was held in the United States. Valeant now plans to transfer most legacy Salix intellectual property to Ireland. Specifically, Salix will license certain intellectual property to VHI, which acts as a principal for the global Valeant group.[121] As compensation for the transfer, VHI "will pay a running royalty to Salix calculated as a percentage of third-party net sales," and it will acquire an option to purchase that intellectual property outright from Salix in the future.[122] The royalties paid under that license will be "determined on a product-by-product basis based on analysis of the current value and risk profile" of each product.[123] Because Salix will become a member of Valeant's U.S. consolidated group, however, Salix's taxable income associated with the intellectual property transfer going forward "will be offset with interest expense and other tax attributes."[124]

As with the Medicis and Bausch & Lomb acquisitions, the practical result of this restructuring is that VHI will contract with related-parties and third-parties to manufacture Salix products and then sell those products as finished goods to a member of Valeant's U.S. group, VPNA. VPNA will earn a return only on its product distribution, sales, and marketing activities. As a result, Valeant will source all income from Salix products to Ireland, except for royalties that VHI pays to its U.S. group for use of Salix intellectual property based on the value at the time of transfer.[125] As with Medicis's and Bausch & Lomb's intellectual property, if Valeant is successful in its plans to enhance the profitability of Salix intellectual property, the lion's share of those increased or "synergized" profits will flow to VHI and be taxed at the lower Irish rate.

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[120] Valeant Resp. II, 4.
[121] Valeant Resp. II, 3.
[122] *Id.*
[123] *Id.*
[124] Valeant Resp. II, 4. Valeant notes that, as an alternative to a perpetual license, Valeant may transfer Salix intellectual property to VHI through an outright sale. *Id.*
[125] Valeant Resp. I, 2-3.

2. Intercompany debt

Valeant structured the Salix acquisition debt in a manner that will significantly reduce Valeant's U.S. tax base. Valeant-Canada raised $15.2 billion in debt financing from third parties to support the Salix acquisition. Valeant then made an interest-free loan of $16.5 billion to VFL (Luxembourg). VFL, in turn, made six intercompany loans totaling $16.5 billion to VPI Delaware at an average interest rate of approximately 6.2%. Valeant projects that, from the first quarter of 2015 through the first quarter of 2017, it will make $1.67 billion in interest payments on the Salix debt to VFL; those payments are scheduled to continue until the maturity date of each loan (ranging from 2021 to 2025).[126] To date, Valeant's interest payments on the Salix acquisition debt have been fully deductible in the U.S. and subject to no U.S. federal withholding taxes.[127] Only a portion of the interest income received by Valeant in Luxembourg is taxable—at single-digit tax rates.

D. Employment Impact of Valeant Acquisitions

As with many mergers and acquisitions, Valeant's purchases of Medicis, Bausch & Lomb, and Salix were followed by significant workforce reductions.

Medicis had approximately 790 full-time employees in the U.S. in the quarter immediately preceding the acquisition.[128] Valeant reported in public filings that it terminated approximately 750 employees "as a result of the Medicis Acquisition."[129] Based on other employment data supplied by Valeant, however, it is clear that all or substantially all of the job cuts were U.S.-based Medicis positions, including approximately 450 employees at the Scottsdale, Arizona headquarters.[130]

Bausch & Lomb had approximately 4,103 full-time employees in the U.S. in the quarter immediately preceding the acquisition.[131] Valeant reported in public filings that it terminated "approximately 3,000" employees of Bausch & Lomb and

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[126] Valeant Resp. I, 20-21; Valeant Resp. II, 11-12.
[127] Valeant notes that "some deductions were limited pursuant to 163(j)," but as of December 31, 2014, those previously limited deductions have been allowed. Valeant Resp. III, 3.
[128] Valeant Resp. I, 16.
[129] Valeant 2013 10-K, at 33, *available at* http://ir.valeant.com/investor-relations/SEC-Filings/2013/default.aspx.
[130] Valeant Resp. I, 16; Valeant Resp. II, 16.
[131] Valeant Resp. I, 16.

of Valeant "as a result of the Bausch & Lomb Acquisition."[132] The company reported to the Subcommittee that approximately 1,500 of those terminated positions were in the U.S.—about 1,125 Bausch & Lomb employees, and 375 legacy Valeant employees.

At the time of the acquisition, Salix employed approximately 977 full-time workers in the U.S.[133] Workforce reductions at Salix were significantly greater than has been publicly reported. Valeant has eliminated or plans to eliminate approximately 420 Salix jobs—including 261 headquarters jobs in North Carolina and 160 jobs based in other U.S. locations.[134]

In addition to reducing the target company's workforce, Valeant plans to transfer some contract manufacturing out of the United States in connection with the Medicis and Salix acquisitions. Specifically, Valeant reports that it has transferred or will soon transfer manufacturing work from some contract sites in North Carolina, Texas, Kentucky, and Tennessee to sites in Canada and the UK. Valeant will move contract manufacturing business from one site in Canada to North Carolina. Although job impact figures are not available, the net U.S. contract manufacturing revenue loss is approximately $16.5 million annually.[135]

Valeant's total U.S. workforce has grown from 607 U.S.-based full-time employees as of December 2011 to 5,725 U.S.-based full-time employees as of June 2015.[136] Valeant's total non-U.S. workforce grew in the same time period from 6,293 full-time employees to 13,644 full-time employees. The vast majority of that headcount increase appears to be attributable to the retained workforce of acquired companies.

II. Burger King Worldwide + Tim Hortons Inc.: Cross-Border Merger of Equals

In addition to foreign acquisitions of U.S. companies, the Subcommittee also examined a merger of equals transaction. In 2014, American fast food giant Burger King Worldwide merged with Tim Hortons, Inc., a Canadian fast food restaurant known for its coffee and donuts. Burger King paid $11.4 billion to acquire Tim

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[132] Valeant 2014 10-K, *available at* http://ir.valeant.com/investor-relations/SEC-Filings/2014/default.aspx.
[133] Valeant Resp. I, 18.
[134] Valeant Resp. III, 2 & Table H-2.
[135] Valeant Resp. III.9, Table D-1 & E-1.
[136] Valeant Resp. III, Table A-2.

Hortons, and both brands were placed under the umbrella of a new company called Restaurant Brands International (RBI), headquartered in Ontario, Canada.[137] As part of the deal, Warren Buffet's Berkshire Hathaway provided $3 billion in preferred equity funding.[138] It has been widely reported that the decision to locate RBI in Canada allows Burger King to recognize substantial tax benefits with respect to its international operations.

A brief history of both companies is helpful to understand the decision to merge and the role that tax considerations played. Founded in 1954 in Miami, Florida, Burger King is renowned for its signature burger, the Whopper. Like other prominent fast food chains, Burger King grew quickly and substantially and today has more than 7,000 franchise-owned restaurants in the United States.[139] By 2013—the last full year before the merger—Burger King had nearly $1.1 billion in revenues, $230 million in profits, and an $11.4 billion market capitalization.[140] The company has been acquired and sold several times during its history. Most recently, in 2010, 3G Capital, a Brazilian investment management firm, purchased Burger King for $4 billion[141] in a take-private deal.[142] After two years of streamlining Burger King's operations, 3G took the company public in 2012.[143]

Tim Hortons was founded in 1964 by Hall of Fame National Hockey League player Tim Horton. It has thousands of franchises across Canada, enjoys a dominant 42% share of the quick service restaurant industry in Canada,[144] and is seeking to add 500 new restaurants its home country by 2018.[145] From 1995

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[137] *See* Paul Vieira, *Canada Approves Burger King's Deal to Buy Tim Hortons*, WALL ST. J. (Dec. 4, 2014), http://www.wsj.com/articles/canada-approves-burger-kings-deal-to-buy-tim-hortons-1417728183.
[138] William Alden, *In Burger King Deal, Buffett Teams up Again with 3G Capital*, N.Y. TIMES DEALBOOK (Aug. 26, 2014), http://dealbook.nytimes.com/2014/08/26/in-burger-king-deal-buffett-reunites-with-3g-capital/.
[139] Burger King Worldwide, Inc., Annual Report (Form 10-K) (Feb. 21, 2014), *available at* https://www.sec.gov/Archives/edgar/data/1547282/000119312514061827/d648966d10k.htm#tx648966_1 [hereinafter *Burger King 2013 Form 10-K*).
[140] Liz Hoffman & Dana Mattioli, *Burger King in Talks to Buy Tim Hortons in Canada Tax Deal*, WALL ST. J. (Aug. 25, 2014), *available at* http://www.wsj.com/articles/burger-king-in-talks-to-buy-tim-hortons-1408924294.
[141] *Burger King Holdings*, 3G CAPITAL (Sept. 2, 2010), http://www.3g-capital.com/bkw.html.
[142] Anupreeta Das & Mark Peters, *Burger King Goes Public Again*, WALL ST. J. (Apr. 4, 2012, 12:14PM), http://www.wsj.com/articles/SB10001424052702303816504577322270322801942.
[143] *Id.*
[144] TIM HORTONS, WINNING IN THE NEW ERA (n.d.), *available at* http://www.timhortons.com/us/en/pdf/Tim_Hortons_2013_AR_full.pdf.
[145] *Id.*

through 2006, Tim Hortons was owned by U.S. fast food chain Wendy's.[146] But after years of stalled growth, activist investors pressured Wendy's to spin off Tim Hortons into an independent company, which it did in 2006.[147]

Prior to the merger, Burger King expected that expansion in overseas markets would be a major driver of its growth.[148] To be sure, Burger King continues to work on growing its U.S. market share, in part through re-modeling.[149] But Burger King's primary growth strategy focuses on expanding its overseas operations. As the company's Chief Financial Officer Joshua Kobza put it—one suspects hyperbolically—Burger King expected "110%" of its growth would come from new restaurants overseas.[150]

Like Burger King, Tim Hortons' pre-merger growth plan also called for significant international expansion.[151] In a 2013 strategic plan, the company detailed how it would grow outside of Canada. Describing the U.S. market as a "must-win battle," the company announced its goal of opening 300 restaurants in key U.S. markets by 2018, primarily in the Midwest and Northwest.[152] Tim Hortons also outlined its growth strategy beyond North America, explaining that it would first focus on Persian Gulf states, where it hoped to eventually open 220 restaurants.[153] Indeed, Tim Hortons projected that, between 2013 and 2018, it

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[146] Murad Hemmadi, *Lessons for Burger King from the Tim Hortons-Wendy's Merger*, CANADIAN BUS. (Aug. 25, 2014), http://www.canadianbusiness.com/companies-and-industries/tim-hortons-wendys-merger-lessons-burger-king/.
[147] Hoffman & Mattioli, *supra* note 140.
[148] Michael J. De La Merced & Ian Austen, *Global Web of Financial Connections in Burger King's Deal for Tim Hortons*, N.Y. TIMES DEALBOOK, http://dealbook.nytimes.com/2014/08/26/burger-king-to-buy-tim-hortons-for-11-4-billion/ (last updated Aug. 26, 2014, 9:21PM).
[149] Specifically, Burger King is seeking to cultivate a modern image by remodeling its restaurants to incorporate corrugated metal, brick, wood, and concrete, in a design that "draws inspiration from [its] signature flame-grilled cooking process." *See* Burger King 2013 Form 10-K.
[150] Subcommittee Interview with Joshua Kobza, Chief Fin. Officer, Rest. Brands Int'l (June 3, 2015) (noting that "110% of our growth" was expected to be international).
[151] Bruce Philip, *Tim Hortons' New CEO Explains How He Plans to Make Canada's Best Brand Better*, Canadian Bus. (May 14, 2014), http://www.canadianbusiness.com/lists-and-rankings/best-brands/2014-tim-hortons-marc-caira-interview/.
[152] *See* TIM HORTONS, WINNING IN THE NEW ERA (n.d.), *available at* http://www.timhortons.com/us/en/pdf/Tim_Hortons_2013_AR_full.pdf ("We expect to open approximately 300 restaurants in the U.S. by the end of 2018.").
[153] *See id.* ("We have established a roadmap to 220 restaurants in the GCC within five years based on our current agreements.").

aimed to grow by 42% overseas, compared to 3% in Canada and 7% in the United States.[154]

The Subcommittee reviewed nonpublic deal-related documents to better understand the role that tax considerations played in the merger. It is clear from that record that while non-tax business considerations spurred Burger King's interest in concluding the merger in the first place, tax considerations dominated the decision to place the new headquarters outside of the United States. Before the merger, Tim Hortons and Burger King had similar effective tax rates. In 2013, Burger King had a cash effective tax rate of 29%,[155] while Tim Hortons' paid approximately 26%. Those similar effective tax rates, however, masked an important difference in the two companies' tax profiles: While Tim Hortons was free to repatriate its foreign earnings to Canada without incurring any significant residual tax, Burger King was required to pay residual tax on its foreign earnings. It therefore had significant "locked out" earnings from its restaurants through Europe, Asia, Africa, and the Middle East.[156] Before the acquisition, Burger King had approximately $700 million in locked-out foreign earnings in 2014, and it expected that its accumulated foreign earnings and profits would "grow significantly" in future years as it opened new restaurants overseas.[157] The company calculated that, if it repatriated those future earnings to invest in the United States, its worldwide effective tax rate would climb up to 40%.[158]

Beginning in December 2013, Burger King executives worked with the company's majority shareholder, 3G Capital, to evaluate a potential merger with Tim Hortons.[159] Presentations by Burger King executives to its board of directors indicate that Burger King's initial interest in combining with Tim Hortons was business-driven, not primarily tax-motivated. As reported to the board, company executives saw Tim Hortons as a quick service restaurant business with a "consistent track record of growth, a fully-franchised, healthy, and fragmented [diversified] franchisee base,"[160] and they believed the combination would help

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[154] *See* Burger King Internal Presentation on Project Red, Aug. 25, 2014, App. 21 (BKW-PSI-001437). Burger King's deal documents refer to Burger King as "Blue," Tim Hortons as "Red," the planned merger as "Project Red," and the combined company as "New Red."
[155] Letter from Burger King Worldwide to PSI (July 24, 2015), 10 ("BKW Resp.").
[156] App. 29 (BKW-PSI-001696).
[157] *Id.*
[158] App. 27, 29 (BKW-PSI-001693, 1696); BKW Resp., 10.
[159] Subcommittee Interview with Joshua Kobza, Chief Fin. Officer, Rest. Brands Int'l (July 22, 2015).
[160] App. 8 (BKW-PSI-001369).

diversify Burger King's current concentration in the United States.[161] Burger King executives also saw "meaningful value creation" through spurring Tim Hortons' "untapped growth opportunities through [restaurant] expansion abroad"[162] and expected to create shareholder value by achieving significant cost savings.[163] In short, the company appears to have had a clear business rationale for the merger.

But on the issue of *how* to execute the merger and whether to locate the new headquarters in the United States or elsewhere, tax considerations were dispositive. In a March 2014 board presentation, Mr. Kobza and Burger King's Chief Executive Officer Daniel Schwartz laid out the case for the initial bid for Tim Hortons for $73(Canadian) per share. The presentation recommends a combination-migration in which the new headquarters would be in the United Kingdom.

Burger King management, in consultation with outside advisors including KPMG and the law firm Paul Weiss, considered a number of potential jurisdictions for headquarters, including the UK, Canada, Belgium, and Ireland—but did not seriously consider the United States.[164] They assessed each potential jurisdiction's tax rates and corporate governance requirements[165] and initially recommended the UK based primarily on its "low statutory corporate tax rate of 21%" and 0% withholding tax rate on dividends paid to the UK from most jurisdictions.[166] Although Burger King told the Subcommittee that it "did not intend" to place the combined company in the UK,[167] the March 2014 board presentation by Mr. Schwartz and Mr. Kobza clearly states that the creation of a UK parent company was part of a proposed merger plan.[168] Indeed, the financial projections in the presentation assume a combined company with a 23% worldwide effective tax rate—the rate Burger King believed would be achievable through a UK-based corporate group.[169]

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[161] App. 16 (BKW-PSI-001410).
[162] *Id.*
[163] App. 8, 20 (BKW-PSI-001369, 1427).
[164] App. 32-44 (BKW-PSI001833-45); Subcommittee Interview with Kobza (July 23, 2015).
[165] App. 32-44 (BKW-PSI0001833-45).
[166] App. 45 (BKW-PSI-001897).
[167] BKW Resp., 2.
[168] *See* App. 6 (BKW-PSI-001681) ("The merger would be executed via an inversion into a newly-formed U.K. company."); *id.* ("We would also subsequently implement a series of tax efficient corporate reorganization steps to move non-U.S. assets out from under both Blue [Burger King] and Red [Tim Hortons] to be directly owned by the new U.K. holding company to facilitate tax-efficient access to future offshore earnings.").
[169] App. 28 (BKW-PSI-001694).

The United States was not under serious consideration to serve as the headquarters for the combined company because its high statutory rate and tax on repatriated earnings would have "destroyed so much value," according to Mr. Kobza.[170] Burger King executives wanted a platform that would accelerate, not hinder, the combined company's international growth. As noted, Burger King expected that its non-U.S. earnings would "grow significantly" in the year ahead,[171] and more than 80% of Tim Hortons' earnings derived from non-U.S. sales.[172] Burger King executives determined that, after the merger, the combined company would need to repatriate its non-U.S. earnings.[173] But repatriating Burger King's and Tim Hortons' income to a corporate headquarters in the United States would have driven the combined company's tax rate up to 40%.[174] That "11% increase in [effective tax rate] would lead to a 15% decline in Net Income" for Burger King alone, not including the impact on Tim Hortons.[175]

Headquartering the combined company in the United States was a nonstarter. Mr. Kobza explained that the "tax dissynergies" from placing the combined company headquarters in the United States would have made the merger infeasible. If placed under a U.S. parent, all of Tim Hortons' non-U.S. revenues would be pulled into the U.S. tax net. Mr. Kobza indicated that imposing that additional tax burden on Tim Hortons' Canadian earnings alone would have sunk the deal.[176] In addition, Burger King's growing foreign earnings would continue to be inaccessible—unless the company paid additional taxes for the privilege of reinvesting those earnings in the U.S. Mr. Kobza explained that Burger King never seriously considered pursuing this "hypothetical" U.S.-headquartered approach.[177] His March 2014 presentation to the Board demonstrates why: When compared to the UK option, locating the headquarters in the U.S. and repatriating its future foreign earnings would have destroyed approximately $5.5 billion in future value for the new Burger King and Tim Hortons over five years.[178]

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[170] Subcommittee Interview with Kobza (July 23, 2015). Mr. Kobza noted that placing RBI's headquarters in the United States "would have destroyed so much value that I don't know how you would have made the math work." *Id.*
[171] App. 29 (BKW-PSI-001696).
[172] *See* Burger King Internal Presentation on Project Red, Aug. 25, 2014, App. 21 (BKW-PSI-001437).
[173] Subcommittee Interview with Kobza (July 22, 2015); BKW Resp., 10.
[174] App. 27, 29 (BKW-PSI-001693, 1696); BKW Resp., 10.
[175] App. 31 (BKW-PSI-001825).
[176] Subcommittee Interview with Kobza (July 22, 2015). Mr. Kobza noted that Tim Hortons' 26% tax rate would have been "grossed up to 40%" in a U.S.-headquartered scenario. *Id.*
[177] Subcommittee Interview with Kobza (July 23, 2015).
[178] App. 25 (BKW-PSI-001672); Subcommittee Interview with Kobza (July 23, 2015).

On March 24, 2014, Burger King submitted a non-binding proposal to Tim Hortons to acquire all outstanding common shares of Tim Hortons for C$73 per share, payable in cash and stock of the combined company. The proposal would have formed a company that owned both Burger King and Tim Hortons.[179] Tim Hortons rejected the offer on April 25. Two weeks later, on May 12, 2014, Burger King sent Tim Hortons a revised proposal increasing its offer to C$78 per share. That proposal also did not result in negotiation.

In June 2014, Burger King executives presented a revised merger plan to the Burger King board with two significant changes. The presentation proposed increasing the offer price from C$78 to C$85—a 44% premium over Tim Hortons' average 30-day stock price—and it stated that the "combined company will be domiciled in Canada instead of the UK."[180] The presentation explained that placing the headquarters in Canada, rather than the UK, "will likely be viewed more favorably by [Tim Hortons]" and other "key stakeholders."[181] Burger King determined that locating the headquarters in Canada would carry "similar tax benefits as the UK,"[182] with a projected GAAP effective tax rate of approximately 22%.[183] Like the UK-based structure, a Canadian holding company would "allow for tax-efficient access to non-U.S. profits for both [Burger King] and [Tim Hortons]."[184] The presentation explained that, "[s]imilar to the prior [UK-based] structure, we plan to implement a series of tax-efficient reorganization steps to move non-U.S. assets out from under both [Burger King] and [Tim Hortons] to be directly owned by the new Canadian holding company to facilitate tax-efficient access to future [non-U.S.] earnings."[185] Due to Canada's territorial system of taxation, these steps would allow the new combined company to bring home its earnings from its restaurants in Europe, Asia and Africa without incurring additional taxes.

Just as placing the combined company in the U.S. would have destroyed shareholder value, Burger King projected that placing the combined company in Canada would create significant value. In its analysis of the merger, Burger King calculated that tax savings would drive fully one-third of the expected "value

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[179] BKW Resp., 3.
[180] App. 9 (BKW-PSI-001370).
[181] *Id.*
[182] App. 12 (BKW-PSI-001383).
[183] App. 13 (BKW-PSI-001385). Although the UK statutory rate is lower, Burger King determined it could achieve a lower rate in Canada due to greater opportunity to deduct interest expense associated with the acquisition. Subcommittee Interview with Kobza (July 23, 2015).
[184] App. 8 (BKW-PSI-001369).
[185] App. 11 (BKW-PSI-001375).

creation" for shareholders from the merger.[186] The company projected approximately $7 per share in incremental value from cost efficiencies and other fundamentals, and another $4 per share in incremental value from tax savings. Without those tax savings, Burger King could not have hit the value creation target that it uses to evaluate whether a major merger or acquisition is sufficiently profitable to undertake.[187]

In its submissions to the Subcommittee, Burger King has emphasized the role of non-tax considerations in its ultimate decision to place the combined company in Canada rather than the UK. The company also notes that it never proposed the UK structure to Tim Hortons. Mr. Kobza explained that, after the initial bid in March, Burger King's investment bankers reported that the leadership of Tim Hortons strongly preferred to keep their company headquartered in Canada.[188] At the time, Burger King executives reported to the Burger King board that a move to Canada would "likely be viewed more favorably" by Tim Hortons.[189] The presentation also notes that the effective tax rate for the Canada-based structure would be slightly lower than the effective tax rate for the UK-based structure. It further notes that placing the headquarters in Canada would satisfy the "substantial business activities" safe harbor of anti-inversion rules contained in section 7874 of the U.S. tax code. Because neither company has headquarters functions in the UK, the UK structure would not have qualified for that safe harbor and therefore would have had to satisfy other requirements of section 7874.

Burger King has also emphasized the role that the Investment Canada Act (ICA) played in its decision to place the new headquarters in Canada instead of the UK. Because the company redacted a portion of its internal analysis regarding the ICA on privilege grounds, the Majority Staff cannot evaluate the degree to which ICA concerns drove the company's decision-making. But the board presentations provided by Burger King suggest that the ICA was at most a second-order consideration.[190] In any event, Burger King executives had already ruled out the

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[186] App. 10 (BKW-PSI-001371) ("2/3rds of additional value is from fundamentals, leverage, and cost savings, while 1/3rd is from tax savings").
[187] App. 10 (BKW-PSI-001371); Subcommittee Interview with Kobza (July 23, 2015).
[188] *Id.*
[189] *Id.*
[190] *See* App. 12 (BKW-PSI-001383) ("The proposed migration to Canada will be viewed more favorably by the [Tim Hortons] Board, [its] shareholders, and [Investment Canada Act] Ministers.").

U.S. as a potential headquarters due to the additional tax burden before learning about the ICA regulatory risks.[191]

Management for both companies entered negotiations July 23, 2014.[192] On August 15, 2014, Burger King submitted a revised non-binding proposal to acquire all of the outstanding common shares of Tim Hortons for C$88.50. As ultimately adopted by the parties, the transaction resulted in Burger King and Tim Hortons becoming indirect subsidiaries of RBI, based in Canada. The agreement provided that each holder of a common share of Tim Hortons would be entitled to receive either C$65.50 in cash and 0.8025 newly issued shares of RBI in exchange for each common share of Tim Hortons held by the shareholder. Alternatively, Tim Hortons shareholders could elect to receive C$88.50 per share. The deal closed in December 2014, after approval by Canadian regulators.

III. InBev's Acquisition of Anheuser-Busch

In July 2008, the 150-year-old American brewer Anheuser-Busch accepted a takeover bid from Belgian conglomerate InBev NV. It was an enormous transaction: InBev, the brewer of premium European beers such as Stella Artois, Beck's, Bass, and Hoegaarden, was at the time the second-largest beer company in the world, while Anheuser-Busch was the third. The $52 billion deal was the second-largest ever in the U.S. consumer goods market, and the third-largest foreign acquisition of a U.S. company.[193] And as with Burger King and Tim Horton's, the combined entity Anheuser-Busch InBev would be headquartered abroad: not in St. Louis, but in Leuven, Belgium.

By 2008, the beer industry had undergone almost a decade of consolidation. InBev itself was the product of a series of mergers. In 2004 Belgium-based Interbrew—which traced its roots back to Leuven, Belgium in 1366[194]—merged with Brazilian brewer AmBev to form InBev. Here in the United States, Anheuser-Busch was the last of the "big three" brewers (Anheuser-Busch, Miller, and Coors) to merge with a foreign brewery. In 2002 South African Breweries ("SAB") bought Miller Brewing for $5.6 billion, creating what was then the second largest brewer

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[191] Subcommittee Interview with Kobza (July 24, 2015).
[192] BKW Resp., 4.
[193] David Kesmodel & Matthew Karnitschnig, *InBev Uncorks Anheuser Takeover Bid*, Wall St. J., June 12, 2008, at A1, *available at* http://www.wsj.com/articles/SB121321760059165613.
[194] *Our Brand*, STELLA ARTOIS, http://www.stellaartois.com/en_us/our-brand/heritage.html (last visited July 28, 2015).

worldwide.[195] The Adolph Coors Company followed suit, combining with Molson, a Canadian brewer, to form Molson Coors in 2005.[196] Those two combined entities—SABMiller and Molson Coors—merged their U.S. operations in late 2007 into MillerCoors, in order to better compete with Anheuser-Busch. At the time, Anheuser-Busch controlled about 50% of the domestic beer market, followed by SABMiller and Molson Coors at 29%.[197]

In 2008 Anheuser-Busch was a $19-billion-a-year Fortune 500 company. Although Anheuser-Busch was the third largest worldwide brewer by volume, 90% of its sales took place in the U.S.[198] With domestic beer consumption per capita declining and craft breweries on the rise, many analysts believed that Anheuser-Busch was approaching saturation levels domestically and needed to expand abroad. This made Anheuser-Busch attractive for foreign bidders well positioned to expand the company abroad.

On June 11, 2008, InBev announced an unsolicited bid for Anheuser-Busch of $46.3 billion. At $65 a share, the bid represented a roughly 30% premium over the company's $50 share price before talks began. Anheuser-Busch attempted to avoid the takeover by combining with Mexico's Grupo Modelo—a move that would have made the combined firm too expensive for InBev to buy.[199] After a month-long pursuit, however, InBev won over Anheuser-Busch with a bid of about $52 billion, roughly $6 billion more than the initial offer.[200] The $70-per-share deal represented a 40% premium over the approximately $50 pre-negotiation valuation. By increasing its offer by $5 per share, InBev successfully drew Anheuser-Busch into friendly discussions and thus avoided a protracted hostile takeover. The combination of the two entities officially closed on November 18, 2008.

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[195] WILLIAM KNOEDELSEDER, BITTER BREW: THE RISE AND FALL OF ANHEUSER-BUSCH AND AMERICA'S KINGS OF BEER 296 (2012).
[196] Ian Austin, *Molson Moves To Ensure Coors Merger Is Approved*, N.Y. TIMES, Jan. 15, 2015, at C3, *available at* http://www.nytimes.com/2005/01/14/business/worldbusiness/molson-moves-to-ensure-coors-merger-is-approved.html.
[197] Andrew Martin, *Merger for SABMiller and Molson Coors*, N.Y. TIMES, Oct. 10, 2007, at C3, *available at* http://www.nytimes.com/2007/10/10/business/worldbusiness/10beer.html?_r=0.
[198] KNOEDELSEDER, *supra* note 195, at 296.
[199] David Kesmodel & David Luhnow, *Anheuser Seeks out a Mexican Ally*, WALL ST. J., June 13, 2008, at B1, *available at* http://www.wsj.com/articles/SB121330336018469157.
[200] David Kesmodel, Dennis K. Berman & Dana Cimilucca, *Anheuser, InBev Reach a Deal for $52 Billion*, WALL ST. J., July 14, 2008, at B1, *available at* http://www.wsj.com/articles/SB121598077288249131.

Today Anheuser-Busch InBev ("AB InBev") is the largest global beer brewer and a top-five worldwide consumer products company with annual revenues of $47.1 billion.[201] AB InBev has operations in 25 countries, sales in over 100 nations, and a global headcount of 155,000.[202] North America, including Mexico, and Latin America are the company's two biggest markets, generating roughly 74.2% of revenue and 70.2% of sales volume in 2014.[203] AB InBev now owns more than 200 brands of beer, 16 of which have estimated retail sales of over $1 billion.[204] The Board of Directors consists of 14 members, four of whom are Brazilian, four Belgian, and one American.[205]

The Subcommittee reviewed AB InBev's responses to a limited set of interrogatories focused on the company's tax profile and employment. The purpose of this inquiry was to assess the role tax considerations played in the acquisition and how the acquisition affected AB InBev's employment figures in the United States, Belgium, and Brazil.[206]

Our review of the AB InBev merger reveals that the transaction was driven by non-tax, business considerations. Nevertheless the tax profiles of the two firms differed greatly pre-acquisition. Anheuser-Busch's worldwide effective tax rate averaged 39.2% from 2005 through 2008, and its foreign earnings were subject to U.S. taxes if repatriated.[207] By contrast, InBev's worldwide effective tax rate before the acquisition averaged 19.7% through the same period.[208] (After the merger, AB InBev was able to maintain an average worldwide effective tax rate of 19.3% from 2008 through 2014.[209])

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[201] EDWARD NEBB, AB INBEV, ANNUAL REPORT 2014 (Marianne Amssoms ed., Natacha Schepkens & Kathleen Van Boxelaer trans., 2014), *available at* http://www.ab-inbev.com/content/dam/universaltemplate/abinbev/pdf/investors/annual-and-hy-reports/2014/AB_InBev_AR14_EN_full.pdf.
[202] *Id.*
[203] *Id.*
[204] *Id.*
[205] *Id.*
[206] At the Subcommittee's request, AB InBev broke down annual employment figures by location and category. The submission provided by AB InBev does not specify the reason for the reductions or the manners in which they were effected—whether voluntarily or involuntarily.
[207] Letter from AB InBev to PSI (July 16, 2015) ("AB InBev Resp. I").
[208] *Id.*
[209] AB InBev Resp. I.

In the years following the merger, non-U.S. income attributable to Anheuser-Busch grew significantly.[210] Had the combined AB InBev adopted the U.S. as its corporate home, it would have faced the following decision: Either repatriate this foreign income into the United States (and pay a significant tax bill) or keep the income abroad, regardless whether that was the most productive use of its capital. Because AB InBev instead had its headquarters in Belgium, it did not face this decision. If the merging parties expected significant non-U.S. growth post-acquisition, easier access to earnings may well have influenced the decision to locate AB InBev outside the U.S. tax net.

It is also clear from the record that a significant number of U.S. jobs were lost following the acquisition. From 2007 to 2015, the number of U.S.-based employees of AB InBev declined by about 30%, while the number of employees based in Leuven, Belgium and in the State of São Paolo, Brazil rose 34%.[211] In particular, the company's U.S. headcount was reduced from 18,345 in 2007 to 12,938 in 2015. That 30% reduction is significantly higher than the 10% to 15% decrease that Anheuser-Busch announced before the merger as part of its restructuring plan.

In fact, due to a spinoff of a side business involving theme parks, the company has actually reduced its U.S.-based workforce by about 42%, going from 22,624 employees in 2007 to 12,938 in 2015. A significant portion of that reduction, however, is attributable to the sale of Busch Entertainment Corporation, which operated Busch Gardens theme parks, to The Blackstone Group in 2009. The Busch Entertainment Group employed roughly 4,500 people in 2008. Excluding the losses associated with the sale of Busch Gardens brings the U.S.-based employment losses to 5,407, which as noted above is a roughly 30% reduction.

Meanwhile, headcount in the state of São Paulo specifically increased roughly 50% from 2007 to 2014, going from 5,910 employees in 2007 to 8,861 in 2015. Between 2008 and 2012, the average yearly increase of State of São Paolo employees was 577. This increase in headcount coincided with an increase in revenue in the North of Latin America. Since 2012, headcount has remained relatively stable (between roughly 8,650 and 8,900 employees), suggesting that staffing levels may have stabilized.

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[210] Letter from AB InBev to PSI (July 28, 2015) ("AB InBev Resp. II). Despite sometimes dramatic yearly fluctuations, non-U.S. income attributable to Anheuser-Busch between 2008 and 2014 greatly exceeded Anheuser-Busch's non-U.S. income from 2003-2008. *See* AB InBev Resp. I. This growth in post-merger income—and fluctuation—is reflective of the company's global growth.
[211] AB InBev Resp. I.

AB InBev Full-Time Employees in St. Louis, the United States, and Leuven, Belgium and São Paolo, Brazil (combined)			
	St. Louis	United States	Leuven, Belgium & São Paolo
2007	5,078	22,624	7,762
2008	4,425	21,401	8,626
2009	3,263	14,346[212]	8,529
2010	2,934	12,691	9,393
2011	2,540	11,989	9,698
2012	2,597	12,614	10,189
2013	2,619	12,640	10,320
2014	2,629	12,862	10,171
2015	2,512	12,938	10,428

The single largest category of U.S. job cuts was in the number of corporate workers, which dropped from 2,588 in 2007 to 1,017 in 2015—a roughly 60% reduction. Since 2007, St. Louis itself lost 1,214 employees out of its 2,037-person corporate workforce.[213] Compared to 2008 employment figures, the corporate workforce in St. Louis has decreased by approximately 53%.[214]

[212] As noted above, this decrease of approximately 7,000 employees in 2009 is partly attributable to the sale of Busch Entertainment Corporation, which accounted for the loss of 4,570 employees. Only 63 Busch Entertainment Corporation employees were based in St. Louis.
[213] The submission provided by AB InBev does not specify the reason for the reductions or the manners in which they were effected—whether voluntarily or involuntarily.
[214] It is unclear from AB InBev's submission whether the 2008 employment figure reflects cuts that took place before or after InBev's offer was accepted in July 2008.

AB InBev Corporate Workforce in St. Louis and the United States		
	St. Louis	United States
2007	2,037	2,588
2008	1,730	2,277
2015	823	1,017

Given the limited nature of the Subcommittee's review of the AB InBev acquisition, it is not possible to assess definitively whether the job loss experienced at Anheuser-Busch was a result of the acquisition. The facts available to the Majority Staff, however, show the Anheuser-Busch employee headcount fell significantly in the United States in the years following the company's change of ownership.

CONCLUSION

The lesson policymakers should draw from our findings is straightforward: The high U.S. corporate tax rate and worldwide system of taxation are competitive disadvantages that make it easier for foreign firms to acquire American companies. Those policies also strongly incentivize cross-border merging firms, when choosing where to locate their new headquarters, not to choose the United States. The long term costs of these incentives can be measured in a loss of jobs, corporate headquarters, and revenue to the Treasury.

APPENDIX

Tim Hortons

BURGER KING

Lender Presentation

September 15, 2014

HIGHLY CONFIDENTIAL

PAGES

BKW-PSI-001324 - BKW-PSI-001358

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Agenda

Ownership and Investment Highlights

Tim Hortons Company Overview

Burger King Company Overview

Strategic Rationale and Key Credit Highlights

Syndication Overview

Appendix

ADDITIONAL PAGES

BKW-PSI-001360 - BKW-PSI-001365

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Project Red

Discussion Materials

June 2014

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BKW-PSI-001366

PAGE

BKW-PSI-001367

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INVESTIGATIONS**

Key Developments Since Initial Bid in March

We are proposing to increase our offer price to Red shareholders but continue to see similar PF value creation due to better-than-expected financing terms, a later closing date, and a revised tax structure

Price & Value Creation

- Propose increasing offer price – from C$78 (32% premium to 30-day VWAP) up to C$85 (44% premium)
- Pro forma value creation (~50% greater than status quo) remains consistent with prior materials due to better-than-expected bank financing terms, a revised tax structure, and a later transaction closing date (deal now expected to close at year-end, leading to higher financing EBITDA)
- The balance of the increase in purchase price will be funded by additional Blue equity issued to Red shareholders while total net leverage will remain consistent with the prior offer. Approximately 2/3rds of the additional purchase price is funded by incremental debt from higher financing EBITDA, with the remaining 1/3rd funded evenly between common equity and incremental preferred equity / cash

Financing

- Term loan pricing is more favorable than presented in the prior materials (L + 300bps vs. L + 350bps assumed in prior materials)
- Investor remains supportive of the transaction and is committed to providing preferred equity financing on the same terms discussed previously
- Although we would prefer the cash/stock deal outlined above, we are prepared to pursue an all-cash transaction if desired by Red. In this case, we would replace Red's rollover equity with equity from new/existing Blue shareholders, which would be fully-backstopped by bridge financing at signing. We have already secured fully-committed bridge financing on attractive terms from the banks

Investment Overview

We continue to believe that a combination with Red represents a compelling opportunity

1. **Attractive Business:** opportunity to acquire the dominant QSR in Canada with meaningful downside protection: consistent track record of growth, a fully-franchised, healthy, and fragmented franchisee base, and significant real estate control
2. **Attractive Valuation:** business trades at a significant discount to fully-franchised peers and has no significant owners
3. **Meaningful Value Creation:** [redacted]
4. **Cost Opportunity:** [redacted]
5. **Tax Optimization:** optimizes tax structure by using currently-available tax rules to move Blue offshore, allowing for tax-efficient access to non-U.S. profits for both Blue and Red

[redacted]

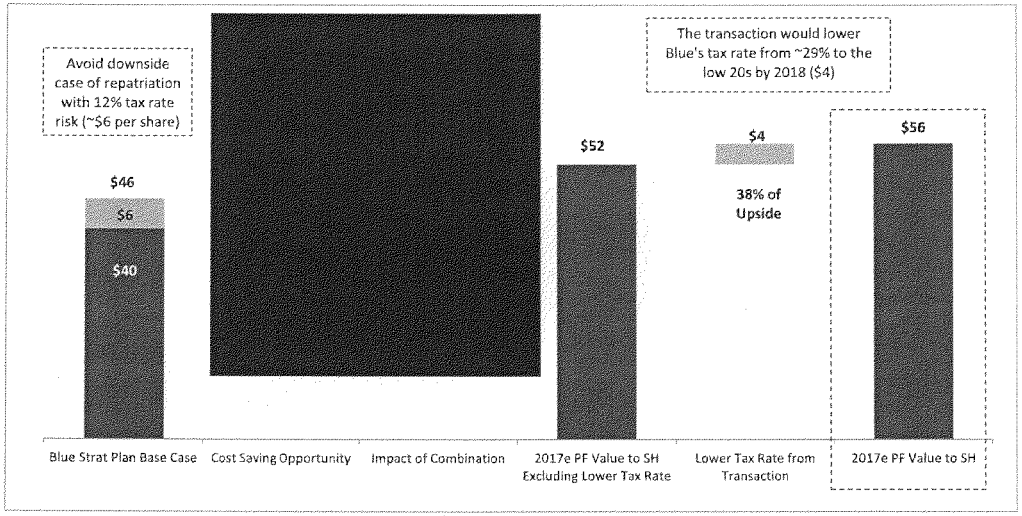
Tax Structure Developments Since Initial Bid in March

The combined company will now be domiciled in Canada instead of the UK, [redacted] and will likely be viewed more favorably by Red

- There have been two major changes to the contemplated tax structure:
  1. The combined company will now be domiciled in Canada (instead of the UK), which will likely be viewed more favorably by key stakeholders
     - Under current tax rules, inversions are permitted under one of two cases: (i.) the combined company has substantial business activities in the country of migration (exact definition provided in Appendix) or (ii.) target shareholders own at least 20% of the resulting company (i.e. the "80/20 rule")
     - Because Red has substantial business activities in Canada, re-domiciling to Canada will successfully satisfy the first requirement
     - Because Red shareholders will continue to own >20% of the combined company, the structure satisfies the second requirement
  2. [redacted] we are now relying on an exchangeable share partnership structure to defer shareholder-level gain until shares are actually sold by US shareholders
- [redacted]
  - [redacted]

We Continue to See ~50% ($4bn) Incremental Value Creation

2/3rds of additional value is from fundamentals, leverage, and cost savings, while 1/3rd is from tax savings



Note: Assumes forward P/E multiple of 21x earnings.

Transaction Overview

The overall transaction structure has not changed meaningfully from the previous materials

- The acquisition will be funded by bank debt (5x net bank leverage), a preferred investment from Investor (5x-7x net leverage), and rollover equity from Red shareholders
  - **Term Loan:** we have received fully-committed financing packages from the banks on terms more favorable than we presented in March. Net bank leverage remains consistent with prior materials while the quantum of term loan has increased due to an increase in EBITDA based on a 2014 year-end transaction closing date
  - **Preferred Equity:** we have continued our dialogue with Investor and he remains committed to providing the preferred equity. We believe using a preferred instrument allows us to reduce dilution, bring in a strong partner, and increase the likelihood of a deal being approved by Red's Board and the Canadian government
  - **Rollover Equity:** Red shareholders will own ~22% of the combined company versus 21% as contemplated in the prior materials
- The transaction would be executed via a merger into a new-formed Canadian holding company. The transaction would not be taxable to Blue shareholders (to be discussed within)
- Similar to the prior structure, we plan to implement a series of tax-efficient corporate reorganization steps to move non-US assets out from under both Blue and Red to be directly owned by the new Canadian holding company to facilitate tax-efficient access to future offshore earnings

Tax Update – Re-domiciling to Canada

Re-domiciling to Canada provides similar tax benefits as the UK and will likely be viewed more favorably by key stakeholders

- [redacted]
- Because the vast majority of Red's operations are based in Canada, if we were to migrate to Canada, the Substantial Business Activities test ("SBA") would exempt us from the requirement that Red shareholders must own 20% of the combined company. SBA applies if the combined company has at least 25% of its employees, income, and assets in the destination country. [redacted]
  - Note that we will continue to satisfy the 20% PF ownership requirement as well
- Relying on SBA provides a number of benefits: (i) [redacted], (ii) the proposed migration to Canada will be viewed more favorably by the Red Board, Red shareholders, and ICA Ministers, and (iii) allows us to offer all-cash consideration to Red shareholders if needed
- The tax rate of a Canada-domiciled HoldCo will be slightly better than a UK-domiciled HoldCo due to differences in debt pushdown and interest income/expense tax rates
- [redacted]
- [redacted]

Tax Rate Considerations

- The effective tax rate of a Canadian HoldCo will be slightly better than the previously-contemplated UK HoldCo
  - Foreign shareholders will continue to be exempt from capital gains taxes
  - Canadian withholding tax rates for shareholders are more favorable than the US, as low as 15% for countries with treaties. But, they are less favorable than the 0% rate in the UK

[redacted]

	UK (Prior Structure)	Canada (Current Structure)
Corp. Income Tax Rate	20%	26.5%
Dividend Tax Rates		
Local Tax on Dividends	0%	0%
W/H Tax on Dividends from US	0%	5%
W/H Tax on Dividends from Canada	5%	N/M
W/H Tax on Dividends Paid to S/H	0% to all countries	15% to US 15% to Switzerland 15% to Netherlands 25% if no treaty (e.g. BVI, Brazil)
Interest Income Tax Rates		
Local Tax on Interest Income	5%	0%
W/H Tax on Interest from US	0%	0%
W/H Tax on Interest from Canada	10%	0%
Incremental Tax on LAC Royalties	5% (net of FTCs)	0%

[redacted]

ADDITIONAL PAGES

BKW-PSI-001372 - BKW-PSI-001374

BKW-PSI-001376 - BKW-PSI-001382

BKW-PSI-001384

BKW-PSI-001386 - BKW-PSI-001394

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Project Red

Board Update

August 13, 2014

HIGHLY CONFIDENTIAL

BKW-PSI-001409

Investment Rationale

We continue to believe that a combination with Red represents a compelling opportunity

1. **Meaningful Value Creation:** [redacted]
   - [redacted]
   - [redacted]
   - Diversifies Blue's current concentration of risk in U.S. and emerging JV markets
   - [redacted]
2. **Cost Opportunity:** [redacted]
   - [redacted]
3. **Tax Optimization:** optimizes tax structure by moving Blue offshore, allowing for tax-efficient access to non-U.S. profits for both Blue and Red
   - Improves Blue's tax rate to low-20's from 40% in fully-distributed standalone scenario
   - Creates a tax-optimized platform for [redacted]

PAGES

BKW-PSI-001411 - BKW-PSI-001423

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Project Red

Discussion Materials

August 25th, 2014

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BKW-PSI-001424

ADDITIONAL PAGES

BKW-PSI-001428 - BKW-PSI-001436

BKW-PSI-001438 - BKW-PSI-001475

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Investment Rationale

The combination with Red will generate substantial value to Blue's shareholders

1. **Meaningful Value Creation:** [redacted]
   - [redacted]
     - Blue's standalone base case incorporates a 29% tax rate, which assumes that Blue finds a way to tax-efficiently access foreign cash. If this is not possible, Blue's standalone tax rate would increase to 40%, and both accretion and incremental value creation from the transaction are significantly higher
   - [redacted]
   - [redacted]
   - [redacted]
2. **Cost Opportunity:** [redacted]
   - [redacted]
3. **Tax Optimization:** optimizes tax structure by moving Blue offshore, allowing for tax-efficient access to non-U.S. profits for both Blue and Red
   - Improves Blue's tax rate to low-20's from 29% today and 40% in fully-distributed standalone scenario
   - [redacted]

Comparison of Prior Base Case to Red's Strategic Plan Model

- Red Strategic Plan projections are more aggressive than our Base Case as a result of significantly higher SSS growth assumptions of ~4% vs. 2%, offset slightly by higher unit growth in our Base Case of ~5% vs. ~4%

[redacted]

Red's Strategic Plan ($USD)

$USD	2013A	2014PF	2015E	2016E	2017E	2018E	'13A-'18E CAGR
Canada Units	3,588	3,716	3,844	3,960	4,053	4,130	*2.9%*
US Units	859	909	958	1,018	1,092	1,182	*6.6%*
Intern Units	38	90	150	178	205	220	*42.1%*

[redacted]

PAGES

BKW-PSI-001425 - BKW-PSI-001426

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Project Red

Discussion Materials

March 2014

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PAGES

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Investment Overview (continued)

1. **Attractive Business:** [redacted]

2. **Actionable Today:** [redacted]

3. **Meaningful Value Creation:** [redacted]

4. **Cost Opportunity:** [redacted]

5. **Tax Optimization: value creation through tax at company and shareholder levels**
   - Utilize currently-available inversion rules to move Blue offshore, reduce Blue's corporate tax rate, and tax-efficiently access non-U.S. cash
   - Would reduce current tax rate of 29% to the low to mid 20's in the medium term vs. potential downside of 40% on a standalone basis
   - Incremental value creation from tax equates to $1.4bn vs. status quo and $5.5bn vs. a scenario where cash is repatriated

Transaction Structure Overview

The transaction can be structured to minimize dilution and not trigger Blue shareholder taxable gain

- [redacted]
  - [redacted]
  - [redacted]
  - [redacted]

- The merger would be executed via an inversion into a newly-formed U.K. company
- Based on current inversion rules, the transaction would not be taxable to Blue shareholders as long as 20% of the PF shares of the new U.K. company is considered rollover equity from Red or from new investors
- We would also subsequently implement a series of tax efficient corporate reorganization steps to move non-U.S. assets out from under both Blue and Red to be directly owned by the new U.K. holding company to facilitate tax-efficient access to future offshore earnings

Status Quo Blue vs. Incremental Value from Red

From a DCF perspective, an acquisition of Red adds meaningful value relative to the Blue status quo

Assumptions:

- [redacted]
- 40% downside tax rate for Blue standalone

[redacted]

Base Case PF Financial Model

[redacted]

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	[redacted]
[redacted]												
GAAP Tax Rate %	*18.9%*	*28.3%*	*27.5%*	*25.4%*	*23.3%*	*23.3%*	*23.3%*	*23.1%*	*22.9%*	*22.9%*	*22.9%*	
[redacted]												

[redacted]

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Transaction Structure – Tax Perspective

An inversion reduces Blue's tax rate and allows for efficient access and distribution of global cash

- Blue currently has a book effective tax rate of 28.5%, which is materially lower than the U.S. corporate tax rate due to offshore IP holdings. However, offshore earnings cannot be repatriated to the U.S. without incurring material additional tax expense
- As we have transitioned to a fully-franchised business model with lower capital expenditures and realized significant earnings growth in EMEA and APAC, cash balances have increased to >$250mm today
- If Blue were to repatriate these cash balances, its corporate tax rate would likely increase to near 40%
- Blue offshore cash balances are expected to grow significantly in 2014 and subsequent years
- [redacted]
  - [redacted]
  - [redacted]
  - [redacted]
  - [redacted]
- [redacted]

Blue – Status Quo

Blue currently has a book effective tax rate of 28.5%, which is materially lower than the US corporate tax rate of 39.6% due to offshore IP holdings in Switzerland and Singapore. However, offshore earnings cannot be repatriated to the US without incurring material additional tax expense

- Prior owners sold EMEA and APAC IP to BKE and BKAP entities in 2006 via "Project One"
    - At the time, offshore earnings were not as significant as they are today and were largely reinvested to build new company restaurants in the regions
- As we have transitioned to a fully franchised business model with lower capital expenditures and realized significant earnings growth in EMEA and APAC, cash balances have increased to >$250mm today
- [redacted]
- Blue offshore cash balances are expected to grow significantly in 2014 and subsequent years
    - Potential uses for this capital include investments [redacted]
    - [redacted]
    - [redacted]

Blue – Status Quo Corporate Level ETR

In connection with the 2013 Strategic Plan process, we projected a long term ETR for Blue of 29%. If our position regarding repatriation of foreign earnings were to change, Blue's ETR would likely increase to >40% (US federal, state, and international withholding taxes).

- An 11% increase in ETR would lead to a 15% decline in Net Income

	Burger King Worldwide - Status Quo Tax Rate Forecast				
$ in thousands	CY 13	CY 14	CY 15	CY 16	CY 17
[redacted]					
WW ETR - Current Structure	29%	29%	29%	29%	29%

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HoldCo Jurisdiction

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BKW-PSI-001833

Governance and Tax Considerations of Different Jurisdictions

Requirements	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]

Governance and Tax Considerations of Different Jurisdictions

Requirements	[redacted]
[redacted]	[redacted]

Selected Corporate Governance Considerations

	CANADA (BCBCA)	CANADA (CBCA)	UK
HEAD OFFICE	[redacted]	[redacted]	[redacted]
LOCAL REPRES. ON BOARD	[redacted]	[redacted]	[redacted]
BOARD SIZE	[redacted]	[redacted]	[redacted]
TERM LIMIT	[redacted]	[redacted]	[redacted]
INDEPENDENCE	[redacted]	[redacted]	[redacted]
DIRECTOR MEETINGS	[redacted]	[redacted]	[redacted]
QUORUM	[redacted]	[redacted]	[redacted]
DIRECTOR LIABILITY	[redacted]	[redacted]	[redacted]

[redacted]

Selected Corporate Governance Considerations

	CANADA (BCBCA)	CANADA (CBCA)	UK
OTHER GOVERNANCE CONSIDER-ATIONS	[redacted]		

[redacted]

Selected Tax Considerations

	CANADA	UK
INCOME TAX	• Corporate Income Tax Rate: 26.5%	• Corporate Income Tax Rate: 21%
WITHHOLDING TAX	• 5-15% income tax treaty withholding tax rate on dividends paid to Canada from most jurisdictions	• 0% income tax treaty withholding tax rate on dividends paid to U.K. from most jurisdictions • 0% withholding tax rate on dividends paid to nonresidents (even if a treaty does not apply) • Controlled foreign corporate rules may provide additional rate relief, e.g. certain income of CFCs may be taxed only at 6.25%

Source: KPMG.

Selected Corporate Governance Considerations

	SWITZERLAND	LUXEMBOURG
HEAD OFFICE	[redacted]	
LOCAL REPRES. ON BOARD		
BOARD SIZE		
TERM LIMIT		
INDEPENDENCE		
DIRECTOR MEETINGS		
QUORUM		
DIRECTOR LIABILITY		

Selected Corporate Governance Considerations

	SWITZERLAND	LUXEMBOURG
OTHER GOVERNANCE CONSIDERATIONS	[redacted]	[redacted]

Selected Tax Considerations

	SWITZERLAND	LUXEMBOURG
INCOME TAX	• Corporate Income Tax Rate: 24.43% (Federal and local)	• Corporate Income Tax Rate: 29.22%
WITHHOLDING TAX	• 0-15% income tax treaty withholding tax rate on dividend paid to Switzerland from most jurisdictions • 35% withholding tax rate on dividends paid to nonresidents (unless a treaty applies)	• 0-15% income tax treaty withholding tax rate on dividends paid to Luxembourg from most jurisdictions • 15% withholding tax rate on dividends paid to nonresidents (unless a treaty applies)

Source: KPMG.

Selected Corporate Governance Considerations

	BELGIUM	IRELAND
HEAD OFFICE	[redacted]	[redacted]
LOCAL REPRES. ON BOARD	[redacted]	[redacted]
BOARD SIZE	[redacted]	[redacted]
TERM LIMIT	[redacted]	[redacted]
INDEPENDENCE	[redacted]	[redacted]
DIRECTOR MEETINGS	[redacted]	[redacted]
QUORUM	[redacted]	[redacted]
DIRECTOR LIABILITY	[redacted]	[redacted]

Selected Corporate Governance Considerations

	BELGIUM	IRELAND
OTHER GOVERNANCE CONSIDER-ATIONS	[redacted]	

Selected Tax Considerations

	BELGIUM	IRELAND
INCOME TAX	• Corporate Income Tax Rate: 33.99%	• Corporate Income Tax Rate: 12.5% – 33% (depending on type of income)
WITHHOLDING TAX	• 10-25% withholding rate on dividends paid to nonresidents	• 5-15% income tax treaty withholding tax rate on dividends paid to Ireland from most jurisdictions • 20% withholding tax rate on dividends paid to nonresidents (unless a treaty applies)

Source: KPMG.

Withholding Tax by Jurisdiction

DIVIDENDS								
	PAYEE	US	BELGIUM	CANADA	IRELAND	LUXEMBOURG	SWITZERLAND	UK
PAYOR	US	NA	0-15%	5-15%	5-15%	5-15%	0-15%	0-15%
	Belgium	0-15%	NA	0-15%	0-15%	0-15%	0-15%	0-15%
	Canada	5-15%	0-15%	NA	5-15%	5-15%	0-15%	5-15%
	Ireland	0%	0%	0%	NA	0%	0%	0%
	Luxembourg	0-15%	0-15%	0-15%	0-15%	NA	0-15%	0-15%
	Switzerland	5-15%	0-15%	0-15%	0-15%	0-15%	NA	0-15%
	UK	0%	0%	0%	0%	0%	0%	NA

INTEREST								
	PAYEE	US	BELGIUM	CANADA	IRELAND	LUXEMBOURG	SWITZERLAND	UK
PAYOR	US	NA	0%	0%	0%	0%	0%	0%
	Belgium	0-15%	NA	10%	0-15%	0-15%	0-10%	0-10%
	Canada	0%	10%	NA	10%	10%	0-10%	10%
	Ireland	0%	0-15%	0-10%	NA	0%	0%	0%
	Luxembourg	0%	0%	0%	0%	NA	0%	0%
	Switzerland	0%	0%	0%	0%	0%	NA	0%
	UK	0%	0-10%	0-10%	0%	0%	0%	NA

Source: KPMG.

Note: Canadian withholding tax is not imposed on distributions that are reductions of capital. In the transaction as contemplated, all distributions from Red Canada OpCo are expected to be non-taxable reductions of capital in the short to medium term

U.K. Jurisdiction Tax Overview

For the following reasons, the United Kingdom is a desirable jurisdiction for New Red

- Low statutory corporate income tax rate of 21%
- By comparison: Canada (26.5% corporate income tax rate); Ireland (12.5 -33% income tax rate depending on the type of income); Switzerland (24.43% corporate income tax rate); Luxembourg (29.22% corporate income tax rate). [redacted]
- [redacted]
- Extensive treaty network
- 0% income tax treaty withholding tax rate on qualifying dividends paid to U.K. from most jurisdictions
- [redacted]
- [redacted]
- [redacted]
- There have been a number of inversions that have already occurred in the U.K., e.g., Aon Corporation, Rowan Companies

ADDITIONAL PAGES

BKW-PSI-001673 - BKW-PSI-001680

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BKW-PSI-001695 - BKW-PSI-001695

BKW-PSI-001697 - BKW-PSI-001823

BKW-PSI-001826 - BKW-PSI-001832

BKW-PSI-001846 - BKW-PSI-001896

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August 31st, 2012

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Project Merlin

August 31st, 2012

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Pharmaceuticals International, Inc

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Executive summary

- Medicis is a dermatology and Aesthetics company focused on Acne products along with an injection Aesthetics platform
  - Public company founded in 1988, with full sales and marketing capabilities
    - Current Derm force of ~170 sales reps; Aesthetics sales force of ~110 sales reps
  - 2011 net sales of $721M with gross margin of 90% and EBITDA of $247M

- Re-reviewing opportunity given recent drop in analyst expectation post Q2 earning call
  - Likely price expectations have dropped as Solodyn future sales expectations have become more clear
  - Have received feedback from Merlin advisors that company is interested in sale and there is general corporate fatigue from continually changing strategies

- Opportunity to build the US Dermatology portfolio and Aesthetics portfolio bolstering presence in acne, and Aesthetic injectable space
  - Oral acne product to compliment topical offerings
  - Restylane and Dysport complement current Sculptra offering
  - Opportunity to leverage current infrastructure to realize corporate synergies

- Preliminary Model at $44/share (~2.6B)
  - **VPNA Tax Rate (36%)**
    - Base case NPV of 981M with an IRR of 14% and payback of 9.1 years
    - Conservative NPV of 9M with an IRR of 9% and a payback of 10+ years
    - Upside NPV of 2,286M with an IRR of 19% and a payback of 6.1 years
  - **Alternate Tax Rate (20%-TBD)**
    - Base case NPV of 1,721M with an IRR of 17% and payback of 7.2 years
    - Conservative NPV of 476M with an IRR of 12% and a payback of 9.1 years
    - Upside NPV of 3,370M with an IRR of 23% and a payback of 5.0 years

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Diligence summary (2/2)

- **HR/Severance**
  - Reviewed employee contracts and company severance policy
  - Based on current synergy estimates we believe calculations are fairly accurate
- **Material Contracts**
  - S&C reviewed current marketed product contracts
  - Finalizing assessment of potential consent requirements needed for in-licensed products and development programs
- **Tax**
  - Reviewed recent tax returns
  - Analysis has shown possible structure for 20% effective tax rate post acquisition
- **Finance**
  - Reviewed historical financials and most recent forecasts
  - No key issues identified

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Summary of Valuations (US Tax Rate 36%)

USD (M)	Base	Conservative	Upside
NPV (Standalone)	1,312	631	2,697
PV of Business	827	526	1,519
TV	485	105	1,178
Synergy NPV	2,439	2,147	2,358
Synergized NPV	3,613	2,640	4,913
NPV @ $44/Share	**981**	**9**	**2,281**
IRR	**14%**	**9%**	**19%**
Payback undiscounted	**9.1**	**10+**	**6.2**

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Summary of Valuations (Tax Rate 20% - TBD)

USD (M)	Base	Conservative	Upside
NPV (Standalone)	1,403	521	3,152
PV of Business	903	515	1,779
TV	500	7	1,373
Synergy NPV	3,118	2,754	3,018
Synergized NPV	4,352	3,107	5,996
NPV @ $44/Share	**1,721**	**476**	**3,364**
IRR	**17%**	**12%**	**23%**
Payback undiscounted	**7.2**	**9.1**	**5.0**

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Tax Benefits

- Large tax on installment sale is offset by:
  - Increased profits attributable to synergies will be taxed at less than 4%
  - Increase interest expense will further erode Merlin's tax base

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ADDITIONAL PAGES

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Established global commercial platform in place

MAJOR INVESTMENT

Revenues in 100+ Countries	3,700 Sales Personnel	Manufacturing in 9 Countries	Development & Research at 25 Sites

LEVERAGE

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ADDITIONAL PAGES

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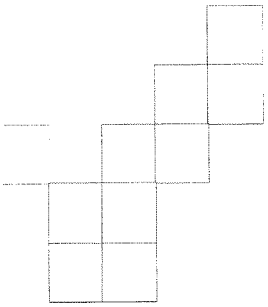

Project Stratos

May 19th, 2013

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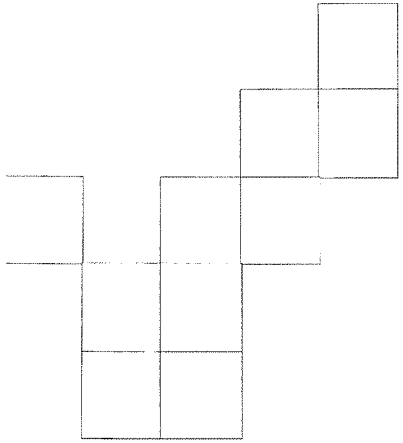

Project Stratos

May 19th, 2013

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VALEANT
Pharmaceuticals International, Inc.

Executive summary

- Opportunity to acquire Bausch & Lomb, leading Ophthalmology focused company from Warburg Pincus
  - Leading Ophthalmology portfolio with leading brands across Rx Pharma, Consumer products, and Surgery
  - Established sales force and commercial operations WW, covering all major markets and geographies
  - WW R&D, supply chain and manufacturing operations, majority of products sold and distributed in house
  - Since privatization, series of management initiatives to cut costs
  - 2012 Expected Sales: ~3B

- Warburg Pincus Acquired B&L in buy-out in 2007
  - ~3.7B buy-out with additional 830M in debt
  - Transaction: ~2B in Cash and 2.5B in Debt

- Opportunity to immediately become leading Ophthalmology company and expand global presence and reach
  - Opportunity for significant further synergies
  - Transaction immediately accretive and reduces debt leverage
  - Opportunity to sell of non-core assets

- Preliminary Model (total deal value of ~8.5B, 4.2B in Debt and 4.3B in Equity)
  - 36% Tax: NPV of 3,535M with an IRR of 12% and payback of 9.7 years
  - 20% Tax: NPV of 3,535M with an IRR of 15% and payback of 8.0 years

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VRXPSI-01-0000613

Company Comparison

	Valeant	Stratos
Market Cap*	$24,366	$4,300
Enterprise Value*	$34,481	$8,500
Shares	311.7	-
Sales - 2013E	$4,790	$3,207
EBITA - 2013E	$2,581	$499
Net Income -2013E	$1,879	$186
EPS	$6.03	-
Net Debt	$10,115	$4,200
Share Price	$78.17	-
P/EBITA	9.4 X	8.6 X
P/E 2013	13.0 X	23.1 X
Net Debt/Market Cap	0.4 X	1.0 X
Net Debt/EBITA 2013	3.9 X	8.4 X
Tax Rate	3.00%	32.00%

*Market Cap and Enterprise value taken as modeled equity and debt

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Pharmaceuticals International, Inc.
VRXPSI-01-0000614
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Key Assumptions

	Base
Sales Growth	[redacted]
COGS	[redacted]
Distribut.	[redacted]
Synergy**	[redacted]
Interest Expense	[redacted]
Depreciation	[redacted]
Other	[redacted] Tax Rate: 36% VPNA; 20% VPII (Based on sale/license of US and Foreign IP) [redacted]

[redacted]

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Summary of Valuations - Base

USD (M)	US Tax (36%)	VPII (20%) - TBD
NPV	$3,535	$3,535
PV of Business	$2,121	$2,121
TV	$1,413	$1,413
Cost Synergy	$6,736	$8,487
Synergized NPV	$10,110	$12,502
NPV @ Price $8.5B	$1,610	$4,002
IRR	12%	15%
Payback undiscounted	9.7	8.0

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Pharmaceuticals International, Inc.

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Geographic Expansion: Exploiting Three Growth Tracks

Newer Market:
Selective
Strategic Actions:

Ex: ARGENTINA

Existing Market:
Leverage Scale
Across All
Segments:

Ex: INDIA

Existing Market:
Introduce New
Segments

Ex: JAPAN

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2013 – 2014 Financial Assumptions

- **All figures presented on Management Basis (non-GAAP)**
  - excludes results of TPV in the historical periods when it had been spun-out into a joint venture
  - excludes unusual or one-time adjustments consistent with those used in calculating Adjusted EBITDA.
- **Major currency assumptions:**
  - Euro: 1.25
  - Japanese yen: 100
- **Assumed EBIT of $[redacted] in 2013 and $[redacted] in 2014**
- **Interest calculations assume June 30 IPO and debt repayment with proceeds and using rates to be effective upon anticipated repricing in May.**
- **Depreciation: $[redacted] in 2013; $[redacted] in 2014**
- **Amortization: $[redacted] in 2013; $[redacted] in 2014**
- **Non-GAAP effective tax rate of ~32% and does not factor any valuation allowance changes. Additionally, does not include the impact of any potential tax settlements on the effective rate.**
- **Stock compensation expense consistent with historical levels ([redacted]). As a public company, this is likely to increase substantially.**

ADDITIONAL PAGES

VRXPSI-01-0000667 - VRXPSI-01-0000692

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December 17, 2014
Specialty Pharmaceuticals - Estimate Changes

Salix Pharmaceuticals Ltd. (SLXP)

Quickly Reducing Inventory; Risks Remain; Reinstating Our Rating at Market Perform

MARKET DATA

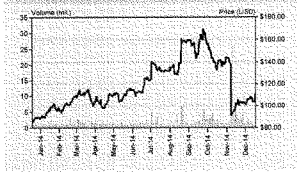
Price	$110.11
52-Week Range:	$83.26 - $172.98
Shares Out. (M):	75.6
Market Cap ($M):	$8,324.3
Average Daily Vol. (000):	865.0
Cash (M):	$423
Total Debt (M):	$2,761

Source: Thomson Reuters and JMP Securities LLC

FY DEC		2013A	2014E	2015E
Revenue ($M)	1Q	$202.8	$384.4A	--
	2Q	$235.4	$382.0A	--
	3Q	$238.2	$354.7A	--
	4Q	$257.6	$155.1	--
	FY	**$933.8**	**$1,276.2**	**$1,355.1**
EPS	1Q	$0.63	$1.05A	--
	2Q	$0.76	$1.59A	--
	3Q	$0.90	$1.53A	--
	4Q	$1.06	($0.55)	--
	FY	**$3.36**	**$3.66**	**$3.91**
	P/E	32.8x	30.1x	28.2x
Previous FY		NC	$5.48	$5.03

Source: Company reports and JMP Securities LLC

STOCK PRICE PERFORMANCE



MARKET PERFORM | Price: $110.11 | Target Price: N/A

INVESTMENT HIGHLIGHTS

Salix Pharmaceuticals provided an updated plan for an expedited inventory work-down, issued 2015-2016 guidance, and announced a three-month Xifaxan IBS PDUFA extension; we are reinstating our rating at Market Perform (our prior rating was Market Outperform). We are pleased that SLXP has chosen to more rapidly draw down its wholesaler inventories by the end of 2015 (vs. end of 2016) to more quickly return to demand-driven results. This move brings 2015 guidance well below consensus and raises 2016 above current consensus. However, in our opinion, the guidance reflects unsustainably low tax rates below SLXP's normalized mid/high-30% rate and if fully taxed, our estimates would be >25% below guidance; thus, we caution against placing a standalone premium multiple on tax-inflated EPS. Investors reacted positively to guidance, the FDA's proactive Xifaxan IBS PDUFA extension, and to SLXP's first-year IBS sales forecast of $125-$150M. However, we think the PDUFA delay may suggest increased odds of another Advisory Committee meeting; something we believe the company does not expect, and a potential wildcard, in our view. The IBS sales forecast is difficult to parse from current off-label IBS use, and is not necessarily incremental to current sales. SLXP trades at ~17x fully taxed (37%) 2016 EPS guidance (which does not appear conservative to us). While it is not overly expensive for a growth story, we note that the already taken-out AGN & AUXL are at 20x and 18x consensus, respectively.

We do not expect an acquisition of SLXP prior to receiving clarity around IBS, resolution on the standing of management and board members, or certainty around regulatory issues or the potential for financial restatement. SLXP provided assurances from E&Y after 3Q that its figures are sound; however, we are not fully comfortable that reported sales/profits that exceed pull-through demand are acceptable, even if 'a sale is a sale'. We question whether the exceptional inventory stocking that appeared to occur over three years across different wholesalers could be perceived as inadvertent. While we like SLXP's underlying assets, we see continued risks to the story and feel that shares are fairly valued currently.

Faster de-stocking, and 2015 and 2016 guidance. Bringing down inventories to three months from nine months on key products by the end of 2015 (vs. the end of 2016) yields lower 2015 net sales guidance ($1.25B-$1.35B vs. the Street's $1.51B), and higher 2016 net sales ($1.9B-$2B vs. the Street's $1.86B). SLXP's product demand projections (Rx growth) are in line with our estimates. EPS guidance for 2015 of $3.10-$4.10 (Street $4.32) reflects an effective 3% tax rate, and 2016 EPS guidance of $8.50-$9.50 (Street $6.12) assumes 14% taxes. We are not yet clear on lower tax rates, but SLXP has historically guided to the mid/high-30% range (thus, its planned "inversion"). Our new estimates fall within guidance ranges, but assuming full/sustainable taxes, our

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FOR DISCLOSURE AND FOOTNOTE INFORMATION, REFER TO JMP FACTS AND DISCLOSURES SECTION.

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PHARMACEUTICALS, INC.

Management Presentation

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Salix Management Projections P&L

Fiscal Year Ended December 31,

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	'18-'19 CAGR	'19-'24 CAGR
Revenue	$1,407[1]	$2,274	$3,198	$3,098	$3,016	$3,377	$3,488	$3,379	$3,143	$3,000			16.8%	14.4%
% Growth	23%	59%[2]	27%	26%	24%	27%	17%	12%	6%	6%				
Gross Profit	$1,148	$1,853	$2,607	$3,372	$4,368	$5,033	$5,613	$7,443	$8,195	$8,579	46.0%	26.0%		
% Margin	82%	82%	81%	80%	87%	89%	90%	92%	93%	93%				
SG&A[3]	(64)	(87)	(552)	(595)	(1,101)	(1,402)	(1,593)	(1,831)	(2,007)	(2,102)				
% of Sales	3%	3%	17%	17%	33%	42%	45%	54%	64%	67%				
R&D[4]	(135)	(223)	(304)	(363)	(407)	(425)	(713)	(824)	(906)	(978)				
% of Sales	10%	10%	10%	12%	13%	13%	20%	24%	29%	33%				
EBITDA	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		
% Margin	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		
Cash Int. Exp.	(165)	(165)	(33)	(16)	(14)	(13)	(6)	(6)	(6)	(6)				
Cash Taxes	(11)	(19)	(64)	(83)	(1,087)	(1,282)	(1,604)	(1,840)	(2,043)	(2,347)				
Cash Tax Rate	3%	14%	37%	38%	37%	37%	38%	38%	38%	38%				
Adj. Net Income	$442	$669	$1,075	$1,269	$1,773	$2,071	$2,674	$3,016	$3,334	$3,688	56.8%	30.0%		
Adjusted EPS	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		
[illegible]	8%	61%	37%	18%	39%	39%	16%	11%	9%	9%				
Shares O/S	77.0	77.0	78.1	78.7	80.7	78.7	79.1	80.7	80.7	80.7				

Source: Financial Projections per Salix management.
Note: Dollars in millions, except per share.
[1] Demand revenue is ~$30[illegible] above revenue due to expected inventory drawdown in 2014.
[2] 2015 incorporates Cash Release Month.
[3] GAAP R&D and SG&A net of stock-based and [illegible] expenses, respectively, as and as pro-forma expense.
[4] EBITDA adds back depreciation and [illegible] expenses of $[illegible] and $[illegible], respectively, in 2014, growing to $[illegible] and $[illegible] in 2024.

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Project Sun

February 6, 2015

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PRELIMINARY - AS OF 2/5/15

Base case 1

Description

[redacted]

IRR sensitivity to price and tax rate

Tax rate	@1% terminal growth	Purchase price $140	$145	$150	$155	$160
	5%	24.50%	24.00%	23.40%	22.90%	22.40%
	10%	23.50%	23.00%	22.40%	21.90%	21.40%
	36%	17.50%	17.00%	16.50%	16.10%	15.60%

IRR sensitivity to price and terminal growth

Terminal growth	@36% tax	Purchase price $140	$145	$150	$155	$160
	-10%	10.80%	10.30%	9.80%	9.30%	8.90%
	-5%	12.90%	12.40%	11.90%	11.50%	11.00%
	0%	16.50%	16.00%	15.50%	15.10%	14.60%
	1%	17.50%	17.00%	16.50%	16.10%	15.60%

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■ [redacted]

PRELIMINARY - AS OF 2/5/15

Base case 2

Description

[redacted]

IRR sensitivity to price and tax rate

Tax rate	@1% terminal growth	Purchase price $140	$145	$150	$155	$160
	5%	17.20%	16.70%	16.30%	15.80%	15.40%
	10%	16.40%	15.90%	15.40%	15.00%	14.50%
	36%	11.40%	11.00%	10.60%	10.20%	9.90%

IRR sensitivity to price and terminal growth

Terminal growth	@36% tax	Purchase price $140	$145	$150	$155	$160
	-10%	9.90%	9.40%	9.00%	8.60%	8.30%
	-5%	10.30%	9.90%	9.50%	9.10%	8.70%
	0%	11.10%	10.70%	10.30%	10.00%	9.60%
	1%	11.40%	11.00%	10.60%	10.20%	9.90%

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AUGUST 9, 2012

Specialty Pharma

SIG

Medicis Pharmaceutical Corporation

Symbol	MRX
Rating	Positive
Price	$33.31
Price target	$40.00
Downside risk	$28.00

Company market data

52 week range	$40.10-$29.76
Shares out.	59.493mm
Market cap.	1,982mm
Average daily trading volume	1,084,799
Beta	0.99

Calendar year December

	2011e		2012e		2013e	
EPS	Prior	Current	Prior	Current	Prior	Current
Q1	0.55A		0.60A		-	
Q2	0.68A	0.45	0.52A		-	
Q3	0.61A	0.81	0.53		-	
Q4	0.56A	0.92	0.80		-	
CY EPS	2.40	2.78	2.45	3.20	3.00	
Revs	721	849	810	953	920	
Consensus	2.54		2.70		-	

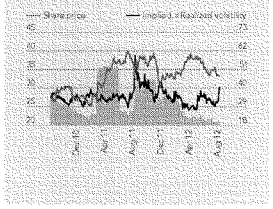
EPS: EPS beginning 2011 are cash EPS excluding amortization

Credit

Gross leverage	11.60%
Net debt/EBITDA (12m fwd)	(1.8)x
Free cash flow (12m fwd)	$174mm
Free cash flow yld (12m fwd)	8.90%
5-yr US treasury yield	0.73%

Derivatives

Volume (contracts)	1,335
Skew rank (2yr %-tile)	37.37



Medicis Pharmaceutical Corporation: Strong 2Q, but Destocking Drives Lower Guidance

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Call to action

There were some positive data points coming out of 2Q, including higher ASPs for key products, strong facial sales and lower costs. Unfortunately, MRX took down its 2H guidance with a delayed recovery for Solodyn and Ziana resulting in destocking shifting more to 3Q, which could take the stock a little lower. Importantly though, we think this dynamic is more ST, and we see the LT outlook remaining solid. At current levels, the stock still seems compelling to us and we maintain our Positive rating.

HIGHLIGHTS

Yesterday, MRX reported a high quality 2Q. Revenue of $197 mln exceeded our forecast and consensus of $191 mln, as well as the guidance range of $185-$195 mln. Cash EPS of $0.52 beat our forecast of $0.45 and the consensus $0.46, as well as guidance of $0.37-$0.47. The key drivers of the upside were higher ASPs for key products (Solodyn, Ziana and Zyclara), strong facial sales (Dysport and Restylane/Perlane), and lower than expected SG&A. Despite the strong quarter, much of the investor focus will be on the lowered guidance, which we thought management did explain well as it relates to the timing of the rebound for Solodyn and Ziana and wholesaler stocking of the product that it had not forecast appropriately (demand curve happening later than MRX thought as a result of the AF program). The good news is AF is working with an increase in the number of profitable Rxs and higher ASPs for Solodyn and Ziana. However, greater uncertainty on the overall numbers could cause investors to take pause with the stock in the near term. We remain confident with the longer term outlook though. We're anticipating an inflection in Solodyn and Ziana Rxs at some point in the next few months, we look forward to the launch of Zyclara 2.5% in 3Q to help accelerate that franchise, and we like the cost-cutting efforts that management is implementing that should continue into next year. It was also good to hear that MRX is filing an NDA in 1Q13 for a therapeutic derm product, since it typically doesn't get credit for its pipeline.

Continued on the next page

Catalysts

Potential inflection in Rxs for Solodyn and Ziana, Zyclara trends with 2.5% formulation launch in 3Q, additional data on pipeline, and/or further M&A.

Downside risk/upside price target

We see $28 as downside if Solodyn generics/pricing have a much greater impact than we expect and both Dysport and the pipeline disappoint, lowering 2015 sales by ~$150 mln

IMPORTANT DISCLOSURES AND CERTIFICATIONS.
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Figure 2: Medicis Income Statement (2007-2015E)

($ Millions Except EPS) Calendar YE Dec 31	(r) 2007	(e+r) 2008	2009	2010	1Q	2Q	3Q	4Q	2011	1QA	2QA	3QE	4QE	2012E	2013E	2014E	2015E	5-Yr CAGR
Revenue																		
Acne	243.4	325.0	388.9	452.4	103.5	123.1	119.1	101.9	447.6	108.5	93.1	88.9	106.0	396.5	443.2	463.0	482.9	
Non-Acne	172.9	148.0	133.6	175.0	52.2	57.7	56.7	54.0	229.6	74.0	61.1	61.3	68.4	324.8	377.6	420.7	457.2	
Non-Derm	41.1	44.7	39.5	62.6	9.2	10.0	9.9	14.5	43.9	19.2	22.4	22.6	24.3	88.7	78.2	65.9	67.7	
New Products	-	-	-	-	-	-	-	-	-	-	-	-	-	-	20.0	50.0	80.0	
Total Revenue	457.4	517.7	572.0	700.0	164.9	190.8	184.7	170.7	721.126	201.7	196.6	193.0	218.7	810.0	920.0	999.7	1,087.8	9%
Cost of Goods Sold	56.1	38.7	56.8	70.0	14.3	18.2	17.2	17.2	66.9	20.9	21.8	21.1	22.8	86.6	92.5	103.4	115.9	
Gross Profit	401.3	479.0	515.2	630.0	150.6	172.6	167.5	153.5	654.2	180.8	174.8	171.9	195.9	723.3	827.5	896.3	971.9	
MRX standalone								23.8		30.7	31.8	30.9	37.7	130.0	138.0	150.0	170.0	
Graceway								3.0		5.5	11.0	7.0	5.0	32.0	25.0	20.0	20.0	
SG&A	243.1	275.0	283.0	322.2	82.7	85.9	90.7	57.0	346.4	90.7	102.6	97.0	92.7	382.0	410.0	420.0	430.0	
MRX standalone								9.3		13.0	11.0	10.0	9.0	41.0	54.0	62.0	70.0	
Graceway								1.1		4.0	4.0	3.0	4.0	16.0	18.0	19.0	20.0	
R&D	31.4	34.9	38.0	39.4	7.1	7.7	7.7	10.4	32.9	12.5	15.4	14.0	13.0	57.0	72.0	81.0	90.0	
D&A	24.5	27.7	29.0	28.3	4.0	3.8	4.0	2.0	13.8	2.3	2.3	2.3	2.3	9.4	9.4	9.4	9.4	
Operating Income	102.3	141.5	164.2	239.1	56.7	75.2	65.1	64.1	261.1	66.2	54.4	58.5	87.9	265.0	336.2	385.9	442.5	13%
EBITDA	126.8	169.2	193.2	268.4	60.8	79.0	69.0	66.2	274.9	68.6	56.9	60.9	90.2	274.3	345.5	395.3	451.9	11%
Non-Op																		
Interest Income	38.8	27.8	7.6	4.2	1.3	1.2	1.3	0.9	4.7	0.7	0.9	1.1	1.3	4.0	8.0	12.0	16.0	
Interest Expense	(10.4)	(10.4)	(4.2)	(4.4)	(1.1)	(1.1)	(1.3)	(1.4)	(4.9)	(1.1)	(2.3)	(2.3)	(2.3)	(8.1)	(9.3)	(9.3)	(9.3)	
Other Non-Op	-	(6.4)	1.5	(0.3)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Total Non-Op	28.4	11.0	4.9	(0.4)	0.2	0.1	0.0	(0.5)	(0.2)	(0.4)	(1.4)	(1.2)	(1.0)	(4.1)	(1.3)	2.7	6.7	
Pre-tax Income	130.6	152.5	169.1	238.7	56.9	75.3	65.1	63.6	260.9	65.8	53.0	57.3	86.8	260.9	334.9	388.7	449.3	
Tax Rate	36.6%	37.7%	37.0%	37.4%	36.5%	36.0%	35.3%	41.3%	37.6%	40.9%	36.5%	39.5%	39.5%	39.6%	39.5%	38.5%	38.5%	
Taxes	47.9	57.4	62.5	89.2	20.8	26.6	23.0	26.3	96.8	26.9	19.3	22.6	34.3	103.2	132.3	153.5	177.5	
Net Income	82.8	95.0	106.5	149.5	36.2	46.7	42.1	37.3	162.3	38.9	33.7	34.7	52.5	157.7	202.6	235.1	271.8	
After-tax Addback	5.4	3.5	(1.0)	(2.0)	(0.3)	(0.7)	(0.5)	(0.4)	(2.0)	(0.6)	(0.4)	(0.5)	(0.5)	(2.0)	(2.0)	(2.0)	(2.0)	
Adjusted Net Income	89.1	98.6	105.5	147.5	35.9	46.0	41.6	36.9	160.4	38.3	33.3	34.2	52.0	155.7	200.7	233.2	269.9	
Average Diluted Shares	71.2	68.3	61.8	54.6	58.4	67.1	67.9	68.4	66.7	63.6	64.0	64.5	68.0	64.3	67.0	69.0	71.0	
Operating EPS	$1.25	$1.49	$1.66	$2.28	$0.55	$0.68	$0.61	$0.56	$2.40	$0.60	$0.52	$0.53	$0.80	$2.45	$3.00	$3.38	$3.80	
Adjusted for FAS 123 (a)	$1.25	$1.49	$1.66	$2.28	$0.55	$0.68	$0.61	$0.56	$2.40	$0.60	$0.52	$0.53	$0.80	$2.45	$3.00	$3.38	$3.80	
																4-Yr CAGR		12%

% Change	2007/ 2006/	2008/ 2007/	2009/ 2008/	2010/ 2009/	1Q	2Q	3Q	4Q	2011/ 2010/	1QA	2QA	3QE	4QE	2012E/ 2011/	2013E/ 2012E/	2014E/ 2013E/	2015E/ 2014E/
Revenue																	
Acne	54%	34%	23%	21%	(14%)	(1%)	1%	(14%)	(7%)	5%	(24%)	(25%)	4%	(11%)	12%	4%	4%
Non-Acne	9%	(14%)	(10%)	31%	52%	41%	12%	27%	31%	42%	41%	46%	38%	41%	16%	11%	9%
Non-Derm	24%	9%	(12%)	8%	(23%)	22%	8%	14%	3%	109%	123%	131%	64%	102%	(11%)	(17%)	3%
New Products	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Total Revenue	31%	13%	10%	22%	(1%)	10%	4%	(1%)	3%	22%	3%	5%	21%	12%	14%	9%	9%
Cost of Goods Sold	34%	(31%)	47%	23%	(9%)	10%	(5%)	(13%)	(4%)	46%	19%	23%	33%	30%	7%	12%	12%
Gross Profit	30%	19%	8%	22%	(0%)	10%	5%	1%	4%	20%	1%	3%	20%	11%	14%	8%	8%
SG&A	31%	13%	3%	14%	9%	5%	10%	5%	6%	21%	19%	7%	6%	13%	5%	2%	2%
R&D	(11%)	11%	12%	1%	(30%)	(27%)	4%	(8%)	(16%)	76%	100%	81%	25%	73%	26%	13%	11%
D&A	7%	13%	5%	1%	(43%)	(47%)	(45%)	(74%)	(53%)	(42%)	(39%)	(41%)	15%	(32%)	-	-	-
Operating Income	59%	38%	16%	46%	(1%)	26%	5%	6%	9%	17%	(28%)	(10%)	37%	1%	27%	15%	15%
EBITDA	45%	33%	14%	39%	(6%)	19%	(1%)	(3%)	2%	13%	(28%)	(12%)	36%	(0%)	26%	14%	14%
Non-Op																	
Interest Income	27%	(28%)	(73%)	(44%)	12%	54%	18%	(25%)	11%	(46%)	(25%)	(15%)	44%	(15%)	100%	50%	33%
Interest Expense	(0%)	-	(59%)	3%	2%	4%	17%	26%	13%	6%	110%	81%	61%	65%	14%	-	-
Other Non-Op	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Total Non-Op	41%	(61%)	(55%)	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	1625%	(69%)	(314%)	147%
Pre-tax Income	55%	17%	11%	41%	(1%)	25%	5%	5%	9%	16%	(30%)	(12%)	37%	(0%)	28%	16%	16%
Tax Rate	13%	3%	(2%)	1%	(5%)	1%	(9%)	16%	1%	12%	(4%)	12%	(4%)	5%	(0%)	-	-
Taxes	76%	20%	9%	43%	(6%)	29%	(4%)	25%	10%	29%	(32%)	(1%)	31%	5%	28%	16%	16%
Net Income	45%	15%	12%	40%	2%	29%	10%	(5%)	9%	7%	(28%)	(16%)	41%	(3%)	28%	16%	16%
After-tax Addback	(3%)	(45%)	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Adjusted Net Income	40%	11%	7%	40%	3%	28%	10%	(5%)	9%	7%	(28%)	(16%)	41%	(3%)	29%	16%	16%
Average Diluted Shares	1%	(7%)	(7%)	5%	2%	4%	5%	2%	3%	(3%)	(5%)	(5%)	(2%)	(4%)	4%	3%	3%
Operating EPS	38%	19%	12%	37%	1%	23%	5%	(7%)	5%	10%	(24%)	(14%)	44%	2%	22%	13%	12%

Footnote

See Margin Analysis for footnotes.

(a) We include FAS123 stock option expense beginning 3Q06

E = SFG Research Estimates NM = Not Meaningful A = Actual

Source: Company Data, SFG Research Estimates

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VRXPSI-02-0000086

ADDITIONAL PAGES

VRXPSI-02-0000087 - VRXPSI-02-0000091

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ORGANIZATION *for* INTERNATIONAL INVESTMENT
Global Investment Grows America's Economy

Organization for International Investment Comments to PSI
Impact of the U.S. Tax Code on the Market for Corporate Control and Jobs
July 30, 2015

The Organization for International Investment (OFII) appreciates the opportunity to submit comments to the Permanent Subcommittee on Investigations relating to the hearing on the impact of the U.S. tax code on the market for corporate control and jobs.

OFII, founded in 1990, is a business association representing U.S. subsidiaries of foreign companies, a business community that plays a critical role in U.S. job creation and economic growth. These insourcing companies directly employ 5.8 million American workers, including 18 percent of the U.S. manufacturing workforce. OFII advocates for policies that increase U.S. competitiveness in attracting foreign direct investment (FDI) and works to ensure fair and non-discriminatory treatment for its member companies. Our fundamental mission is to ensure that the United States remains the most attractive destination for global investment and job creation.

Global investment supports local communities in all 50 states and generates precisely the types of high-value jobs and economic activities that policymakers want to encourage. Despite representing less than one-percent of all U.S. businesses, U.S. subsidiaries produce 21 percent of U.S. exports, support 15 percent of all private-sector research and development, and pay their workers more than 33 percent higher wages than the economy-wide average. They also account for 16 percent of corporate taxes collected in the United States, and their tax payments have doubled since 2002.[1] These U.S. affiliates also pay significant amounts of state and local income, property, and sales and use taxes that support state and local programs.

This hearing comes at a time when the United States is facing an increasingly competitive global landscape for attracting foreign direct investment. Companies have an unprecedented array of options when looking to expand their business and make investments. America's share of global investment has dropped significantly, falling from 37 percent of global FDI in 2000 to just 19 percent in 2013.[2] America cannot afford to continue to lose ground in the race for the world's investment.

As American businesses, OFII's members share many of the same concerns regarding tax policy as other U.S. companies and are united with the broader business community in its support for reducing the U.S. federal corporate income tax rate.

In a recent survey of 101 Chief Financial Officers (CFOs) of insourcing companies, the U.S. tax system was ranked as the top area in need of improvement in order to increase investment in the United States.[3] Furthermore, 54 percent of the CFOs said the corporate tax rate has the most impact on their business out of all U.S. tax policies. The U.S. statutory rate – the highest in the developed world – is out of step with

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[1] U.S. corporate income tax returns filed with the IRS and collected and reported by the SOI Division. Most recent data available.
[2] UNCTDADstat, Most recent data available.
[3] Organization for International Investment and PriceWaterhouseCoopers LLP. (2014). Insourcing Survey. Washington, DC. Web site: http://www.ofii.org/CFOsurvey.

international norms, creates an artificial barrier to inward investment, and harms overall U.S. competitiveness.

Corporate tax reform is an opportunity to make the United States significantly more attractive as a location for business investment in an increasingly competitive global environment. The following data illustrates the importance of ensuring that changes to U.S. tax policy do not discriminate against foreign companies or make the United States a less attractive location for FDI:

FDI Supports Quality Jobs. U.S. subsidiaries of global companies directly employ more than 5.8 million Americans, according to the most recent U.S. government statistics.[4] This accounts for five percent of the total private sector workforce. Insourcing companies, with a combined payroll of $455 billion, pay their employees 33 percent more that the economy-wide average.

FDI Benefits American Communities. FDI provides direct and indirect benefits for American communities. For example, U.S. subsidiaries support a vibrant American supply base, purchasing goods and services from local businesses to sustain and grow their U.S. operations. A recent economic study exploring the impact of FDI over a ten year-period demonstrated that insourcing manufacturers increased their purchase of local intermediate inputs by 48 percent, compared to just 13 percent for U.S. manufacturers overall.[5] Insourcing companies reinvested nearly $100 billion of their earnings back into U.S. operations and spent an additional $201 billion on plant construction and new equipment to upgrade and expand their domestic operations. Furthermore, insourcing companies increased their charitable contributions by 44 percent in the last decade, in stark contrast to an economy-wide contraction in private-sector charitable giving.[6]

FDI Contributes to American Innovation. Annually, the U.S. subsidiaries of foreign companies invest more than $45 billion in domestic research and development, accounting for more than 15 percent of America's private R&D investment. Further, many global companies choose to locate important operations, like R&D centers or regional headquarters in the United States to access a skilled workforce and favorable environment for innovation.

FDI Helps Drive American Manufacturing. More FDI flows into the manufacturing sector than any other area of the economy, accounting for one third of cumulative investments in the United States. In 2013 alone, $95 billion of FDI went to U.S. manufacturing. Insourcing companies employ 2.2 million Americans in high-wage manufacturing jobs, more than 18 percent of all manufacturing jobs in the United States. These insourcing manufacturing jobs have a positive ripple effect, with each manufacturing job at a U.S. subsidiary supporting five additional jobs in the broader U.S. economy.[7]

A large majority of FDI in the United States enters through mergers and acquisitions (M&A). This is not unique to the United States as historical trends indicate that companies entering foreign markets more often merge with or acquire domestic companies to access distribution networks or build on product lines, managerial talent or customer connections. As both the largest global investor and the largest beneficiary of

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[4] U.S. Department of Commerce, Bureau of Economic Analysis (BEA). (Released January 2015).
[5] Organization for International Investment. (2013). *Insourcing companies: how they raise our game.* Washington, DC: Ikenson, Daniel J. Web site: http://www.ofii.org/sites/default/files/OFIIRaisingOurGame_FULL.pdf.
[6] Ikenson 2013.
[7] Organization for International Investment. (2012). *Chain Reaction.* Washington, DC. Web site: http://www.ofii.org/resources/chain-reaction.

FDI, the United States must carefully weigh policy changes that would undermine FDI in the United States or subject U.S. companies to retaliation in foreign markets.

Robust economies require companies to constantly adapt to changes in market trends in order to remain competitive. The ability to make acquisitions or divest certain lines of business helps companies to better serve customers, adapt to technological changes, and enhance value for customers and investors. Business synergies may increase the value of combined companies and acquisitions can help struggling domestic firms with an infusion of capital and access to new customers in foreign markets.

Cross-border M&A typically produces larger synergies because of the greater "gains from trade" available for companies from different countries.[8] They may have access to different stocks of local expertise, varying product types, specialized suppliers or workforces, and different capital markets, all of which can have an important influence on companies' competitive capabilities.[9]

Cross-border M&A is a natural occurrence in the global economy. While it plays a critical role for global economies, cross-border M&A accounts for less than one-third of M&A transactions overall.[10] This means the majority of M&A occurs between domestic firms.

To reiterate, the United States is facing an increasingly competitive global landscape for attracting investment. OFII is united with the broader American business community in its support for comprehensive tax reform that will reduce the U.S. federal corporate income tax rate and encourage greater global investment in the United States.

OFII appreciates the Subcommittee's consideration of the important role M&A plays for cross-border investment and the benefits global investment brings to communities across the United States. OFII looks forward to continuing to work with the Subcommittee to advance comprehensive tax reform that will make the United States the best place to invest and create jobs.

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[8] John Doukas and Nickolaos Travlos, "The Effect of Corporate Multinationalism on Shareholder's Wealth: Evidence from International Acquisitions," *Journal of Finance*, vol. 43, no. 5, December 1988.
[9] Michael Porter, *The Competitive Advantage of Nations*, Free Press, 1990.
[10] EY analysis of the Thomson Reuters M&A database, March 2015.

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September 11, 2015

BY HAND DELIVERY

The Honorable Rob Portman
Chairman
Permanent Subcommittee on Investigations
United States Senate
199 Russell Senate Office Building
Washington, DC 20510

The Honorable Claire McCaskill
Ranking Member
Permanent Subcommittee on Investigations
United States Senate
199 Russell Senate Office Building
Washington, DC 20510

RE: Valeant Pharmaceuticals International, Inc.

Dear Chairman Portman and Ranking Member McCaskill:

On behalf of Valeant Pharmaceuticals International, Inc. ("Valeant"), we write to address the questions for the record submitted by Senator McCaskill following the July 30, 2015 policy-focused hearing conducted by the Permanent Subcommittee on Investigations on the impact of the U.S. tax code on the market for corporate control and jobs. Also, enclosed with this letter please find some comments on the portions of the draft transcript from the hearing that reflect the testimony that Mr. Howard B. Schiller delivered on behalf of Valeant.

As Mr. Schiller explained at the hearing, Valeant is a global specialty pharmaceuticals and medical devices company headquartered in Laval, Quebec with nearly 19,500 employees worldwide, approximately 5,700 of whom Valeant employs in the United States. Valeant's growth has been facilitated in large part by its investments in the United States, and the company has continued to expand its U.S.-based operations, reinvest in its U.S. business, and create good, quality jobs here in the United States. Valeant has 12 manufacturing sites throughout the United States,

with its largest facilities in Rochester, New York; Greenville, South Carolina; Saint Louis, Missouri; Tampa, Florida; and Clearwater, Florida. And Valeant is in the process of expanding its U.S. manufacturing facilities – working with local officials, businesses, and stakeholders to expand its presence and increase its investment in the communities where Valeant operates. The company takes great efforts to ensure that it has the most talented, committed, hard-working, and ethical workforce in the industry, and it is extremely proud of what it has accomplished.

Valeant realizes that the issue on which the Subcommittee's July 30, 2015 hearing focused – how the U.S. tax code affects the market for corporate control – is an important issue for the United States, and Valeant has been pleased to cooperate with the Subcommittee's inquiry on this issue as you and your colleagues explore ways to overhaul the U.S. tax code. Moreover, Valeant very much appreciated the statements that each of you made at the outset of the hearing, in which Chairman Portman recognized that companies like Valeant "played by the rules" and Ranking Member McCaskill asked her colleagues to "resist the urge to demonize foreign companies operating inside the United States."

* * *

Two of the questions for the record submitted to Valeant related to Valeant's decisions to move the production of certain products from third-party contract manufacturers in the United States to manufacturing facilities owned and operated by Valeant in Canada.

The decision to transfer production from certain contract manufacturing operations ("CMOs") (both in the continental United States, as well as in Canada and Puerto Rico) to internal plants in Canada was not purely financial, but also took into account various other factors, including those relating to security of supply. Many of Valeant's products are lower volume and/or were developed decades ago. This combination, which other pharmaceutical companies also face, poses manufacturing challenges as some CMOs prefer not to produce lower volume products, will raise the price substantially for lower volume products or cannot secure the active pharmaceutical ingredient ("API") for these products.

Moreover, some CMOs have previously notified Valeant that they will cease making certain products going forward because, for example, they have been acquired or are being shut down by their parent company. In those circumstances, Valeant frequently has brought drug production in-house rather than transfer production to other CMOs, as Valeant's own plants can conduct a technology transfer faster, will continue to make the product as the volume declines, and may be able to secure API using leverage that a smaller CMO may not have. Additionally,

the cost of a technology transfer into an internal plant is typically 20 to 30 percent lower than transferring production to another CMO.

Even where a CMO is producing a particular drug, pharmaceutical companies like Valeant often prefer to have two sources of manufacturing for risk mitigation on some of the larger volume products, or for strategic products. This means that Valeant will retain a percentage of the business with the CMO and qualify its own plant to be a second source of supply – again, because Valeant's plants can be more flexible in times of crisis or production issues than CMOs.

It should be emphasized that, as noted above, some of the CMOs that Valeant has elected to exit (and transfer into its own plants in Canada), actually were located in Canada or Puerto Rico and not in the continental United States.

Whenever Valeant assesses whether it will relocate manufacturing functions from a CMO to a Valeant facility in Canada, it first asks its internal plants to cost the product based on the "in-year" volume. Valeant then performs an apples-to-apples comparison of the cost of goods (unit standard plus any other cost either party adds outside of the standard) between its internal plant and the CMO. If the Valeant internal plant is at cost (based on the issue being security of supply or lower cost of technology transfer) or more competitive, Valeant will award the business to its internal plant.

* * *

Regarding the remaining questions for the record, which addressed drug prices – a topic acknowledged to not be the subject matter of the July 30, 2015 hearing – as Mr. Schiller testified, Valeant puts patients and customers first, and it does so by maintaining the highest ethical standards in the industry. Valeant is proud of the work it does to promote innovative medicines, which are preventing costly complications of chronic diseases, reducing the number of visits to the emergency room and the length of hospital stays, and helping patients avoid major surgeries. The prices set by pharmaceutical companies – including Valeant – reflect the value of these products in the acute care setting, as well as hospital reimbursement rates.

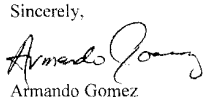
With regard specifically to Isuprel and Nitropress, these are two drugs selected out of a portfolio of hundreds of medications. These are drugs that are only used by hospitals – they are not sold in pharmacies – in accordance with specific surgical procedures. This means that whenever the protocol calls for use of these drugs, they are used. Patients are never denied these drugs when the protocols call for their use. As Mr. Schiller stated during the hearing, the analysis for pricing for a drug is quite complex. Before Valeant acquired the rights to these two drugs, as part of a portfolio of drugs that it acquired from Marathon Pharmaceuticals earlier this

year, the prior owner was evaluating the benefits of these drugs to the system – to both patients and hospitals – and had concluded that the drugs were significantly underpriced. Following the acquisition, Valeant completed the analysis that had been commenced by Marathon, and ultimately decided to adjust the prices to better reflect the benefits that they provide.

When it comes to prescriptions that patients fill at the pharmacy, Valeant maintains patient assistance programs for medicines. The company provides a number of these patient assistance programs to remove the financial obstacles that may keep patients from obtaining the medications they need. Additionally, to help reduce out-of-pocket costs for patients with insurance, Valeant offers copay assistance for many medicines. Information regarding these programs may be found at http://www.valeant.com/about/us-assistance-programs/patient-assistance. Valeant is deeply committed to improving patient care, including offering help to those patients who need it.

Thank you again for giving Valeant the opportunity to provide input to the Subcommittee in connection with its policy-focused hearing on the impact of the U.S. tax code on the market for corporate control and jobs.

Sincerely,



Armando Gomez

Enclosure